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Re: Report on Proposals to Tax the Deemed Realization of Gain on Gratuitous Transfers of Appreciated Property

Dear Ladies and Gentlemen:

The American College of Trust and Estate Counsel (“ACTEC”) is pleased to submit the enclosed report on proposals to tax the deemed realization of gain on gratuitous transfers of appreciated property (the “Report”). This Report analyzes two prior proposals to impose a tax on the deemed realization of gain and is not meant to serve as an endorsement of those proposals, but only an analysis of the technical issues that would arise in the drafting of such tax provisions. ACTEC does not intend that its Report on this subject create any inference that it considers such a tax to be more or less meritorious than any other proposal for changes in the tax law, with regard to otherwise unrealized gains.

ACTEC is a professional organization of approximately 2,500 lawyers from throughout the United States. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of personal income

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tax, transfer tax, and retirement plan rules, and providing advice to IRA and retirement plan administrators on plan administration. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

If you or your staff would like to discuss the Report with the ACTEC Fellows who created it, please contact Beth Shapiro Kaufman, Chair of the ACTEC Tax Policy Study Committee, at (202)862-5062 or bkaufman@capdale.com; or Deborah McKinnon, ACTEC Executive Director, at (202)684-8460 or domckinnon@actec.org.

Respectfully submitted,



John A. Terrill, II
ACTEC President 2019-2020

Enclosures

**REPORT BY THE ACTEC TAX POLICY STUDY COMMITTEE ON
PROPOSALS TO TAX THE DEEMED REALIZATION OF GAIN
ON GRATUITOUS TRANSFERS OF APPRECIATED PROPERTY**

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**REPORT BY THE ACTEC TRANSFER TAX STUDY COMMITTEE ON
PROPOSALS TO TAX THE DEEMED REALIZATION OF GAIN
ON GRATUITOUS TRANSFERS OF APPRECIATED PROPERTY**

On at least two occasions, the United States Government has proposed that an income tax be imposed on unrealized capital gains upon the gratuitous transfer of appreciated property made by an individual during lifetime or on death, hereinafter referred to as a “Deemed Realization Tax.” Under current law, appreciated property may be gratuitously transferred without the realization of capital gains. For lifetime gifts, a donor’s income tax basis for the gifted capital assets is carried over to the donee. At death, a decedent’s capital assets receive a new income tax basis equal to their fair market value at the time of the decedent’s death, resulting in the unrealized gains or losses escaping income taxation altogether. This Report briefly describes two of the prior proposals to impose an income tax on a deemed realization of gain with respect to such gratuitous transfers. The Report then analyzes the various factors that the Government should consider if it were to enact a Deemed Realization Tax. First, briefly, a word about our organization.

A. ACTEC

The American College of Trust and Estate Counsel (“ACTEC”) is an organization comprised of about 2,600 lawyer members (“Fellows”). Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and generation-skipping transfer (GST) tax planning, fiduciary income tax planning, and

compliance. ACTEC offers technical comments about existing and proposed laws and their effective administration but does not take positions on matters of policy or political objectives.

Due to the political nature of the legislative process, ACTEC generally does not comment on proposed legislation. When it decides to do so, it limits its comments to noting how the proposed legislation will impact current law and by making suggestions that may improve the operational effectiveness of the proposed new law. Usually, ACTEC limits its comments to proposed changes to the estate, gift and GST taxes, because those transfer taxes are the areas of the tax law in which its members have substantial expertise. On occasion, ACTEC comments on proposed income tax legislation involving the income taxation of estates and trusts and the beneficiaries thereof because its members also have developed expertise in the income taxation of those entities and individuals. ACTEC believes that any proposed legislation that would impose a tax on the deemed realization of gain on a gratuitous transfer of property during the transferor's lifetime or at death is within the purview of its expertise because in most cases, such transfers also are subject to estate, gift, and/or GST taxes. Any legislation that imposes income tax on a deemed realization of gain on gratuitous transfers of property during lifetime or at death will substantially impact the estate planning process.

This Report analyzes two prior proposals to impose a tax on the deemed realization of gain and is not meant to serve as an endorsement of those proposals. In addition, ACTEC does not intend that its comments on this subject create any inference that it considers such a Deemed Realization Tax to be more or less meritorious than any other proposal for changes in the tax law with regard to otherwise unrealized gains.

B. THE PRIOR DEEMED REALIZATION TAX PROPOSALS

1. The 1969 Proposal

On February 6, 1969, the House Ways and Means Committee and the Senate Finance Committee jointly published “Tax Reform Studies and Proposals of the U.S. Treasury Department.” Therein, the Treasury Department recommended that a capital gains tax be imposed on the deemed realization of gain on the occasion of a gift or bequest of appreciated property. A copy of the pertinent pages of that proposal, hereinafter referred to as the “1969 Proposal,” is attached hereto as EXHIBIT A. Rather than provide a detailed summary of that proposal here, references to the 1969 Proposal will be made throughout this Report.

2. The 2016 Proposal

The Obama Administration’s Fiscal Year 2016 Revenue Proposals recommended the imposition of a tax on the deemed realization of gain with respect to gratuitous transfers of appreciated property. *See* the Treasury Department’s General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals at pages 156 – 57 (Feb. 2, 2015), entitled “Reform the Taxation of Capital Income,” a copy of which is attached hereto as EXHIBIT B, hereinafter referred to as the “2016 Proposal.”¹ Again, rather than provide a detailed summary of the 2016 Proposal here, references to the 2016 Proposal will be made throughout this Report.

The Congressional Joint Committee on Taxation issued a report examining the 2016 Proposal, hereinafter referred to as the “2016 Proposal Joint Committee Report,” a copy of the pertinent portion of which is attached hereto as EXHIBIT C.

¹ The 2016 Proposal was renewed in General Explanations of the Administration’s Fiscal Year 2017 Revenue Proposals at pages 155 – 56 (Feb. 9, 2016).

3. **Comparison of the 1969 and 2016 Proposals**

A detailed comparison of the 1969 and 2016 Proposals is attached hereto as EXHIBIT D.

C. THE CANADIAN DEEMED REALIZATION TAX

Canada imposes a capital gain tax on gratuitous transfers of appreciated property during lifetime and at death. From time to time in this report, reference is made to the Canadian tax for comparison purposes.

D. OPERATION OF THE DEEMED REALIZATION TAX – IN GENERAL

As set forth in the 1969 and the 2016 Proposals, a Deemed Realization Tax would be imposed on gratuitous transfers of appreciated capital assets, either by gift or at death. In essence, the taxpayer would be deemed to have sold such capital assets for their fair market value at the time of the transfer. Under current law a taxpayer generally is deemed to have realized a capital gain only upon the actual sale or exchange of a capital asset.² The taxpayer is able to avoid the capital gains tax by retaining the appreciated capital asset until death, and the asset receives a new basis equal to its fair market value at the time of the taxpayer's death. Consequently, the appreciation is never taxed. A Deemed Realization Tax is aimed at the taxation of the unrealized appreciation by taxing it to the taxpayer either during his or her lifetime with respect to a gift or at his or her death with respect to assets included in his or her gross estate for estate tax purposes. The taxpayer would be "deemed" to have sold (1) gifted assets at the time of the gift and (2) all of the taxpayer's capital assets included in his or her gross

² Under current law, a deemed-sale concept is applied to the recognition of gain or loss (a) in the case of any distribution of property from an estate or trust to which an election under Internal Revenue Code ("IRC") §643(e)(3) applies, (b) on certain transfers to certain foreign trusts and estates under IRC §684, and (c) as a result of the "exit tax" applicable to "covered expatriates" under IRC §877A.

estate for estate tax purposes, even though the taxpayer has not actually sold or exchanged the assets, hence a “deemed realization” even when an “actual realization” has not occurred.

E. RELATIONSHIP OF THE DEEMED REALIZATION TAX TO THE GRATUITOUS TRANSFER TAX REGIME

Under both the 1969 and the 2016 Proposals, a Deemed Realization Tax would not replace the current federal gratuitous transfer tax regime. Instead those proposals would amend the income tax regime by taxing otherwise unrealized capital gains to the taxpayer on the date of a gift and on the taxpayer’s death. Both Proposals would layer the new tax on top of both the current income tax regime and the current gratuitous transfer tax regime. In sharp contrast, Canada has a Deemed Realization Tax, but its tax system differs from the United States’ tax system in that Canada does not impose a tax on gifts, estates, or generation-skipping transfers.

F. RATIONALE FOR THE DEEMED REALIZATION TAX

In the 1969 Proposal, the Treasury Department proffered the following rationales for the adoption of a Deemed Realization Tax:

“Under present law, a person whose income consists of salaries, wages, dividends, or business profits is taxed at ordinary income rates on an annual basis. Special treatment is afforded to income from the sale of capital assets in that such income is taxed at a lower rate when the assets are sold. In both these situations, the estate which the taxpayer passes on to his wife and children at his death is accumulated after income taxes have been paid.

However, a person who holds capital assets which have appreciated in value until death can avoid taxation of this income altogether. Moreover, the recipient of the property takes as his cost or basis the fair market value at the date of death, so that the capital gain income represented by the appreciation in value is never taxed under the income tax. This means that a person who can afford to accumulate income in the form of unrealized capital gains can then pass on that accumulated wealth free of income tax – in contrast to the wage earner, salaried individual, or taxpayer who has sold capital assets, all of whom transfer their accumulated wealth after it is reduced by income taxes.

As a result of this situation: There is inequality in the income tax treatment of people who accumulate their estates out of currently taxable income as compared to those who accumulate estates by means of unrealized capital gains. At least

\$15 billion a year of capital gains fall completely outside the income tax system. There are undesirable economic effects because of the resulting ‘lock-in’ effect.”³

The 1969 Proposal further elaborates as follows concerning the “lock-in” effect:

“When tax liability is allowed to depend on whether an appreciated asset is sold or kept until death, the tax law operates to produce undesirable economic effects, particularly in cases of older people. Assets become immobilized; investors become ‘locked-in’ by the prospect of avoiding income tax completely if they hold appreciated assets until death rather than selling them. This freezing of investment positions deprives the economy of the fruits of an unencumbered flow of capital toward areas of enterprise promising larger rewards.”⁴

In the 2016 Proposal, the Treasury Department provides the following reasons in favor of implementing the new tax:

“Preferential tax rates on long-term capital gain and qualified dividends disproportionately benefit high-income taxpayers and provide many high-income taxpayers with a lower tax rate than many low- and middle-income taxpayers.

Because the person who inherits an appreciated asset receives a basis in that asset equal to the asset’s fair market value on the decedent’s death, the appreciation that accrued during the decedent’s life is never subjected to income tax. In contrast, less-wealthy individuals who must spend down their assets during retirement must pay income tax on their realized capital gains. This increases the inequity in the tax treatment of capital gains. In addition, the preferential treatment of assets held until death produces an incentive for taxpayers to inefficiently lock in portfolios of assets and hold them primarily for the purpose of avoiding capital gains tax on the appreciation, rather than reinvesting the capital in more economically productive investments.”⁵

Both the 1969 and the 2016 Proposals stress the inequities which arise due to the current tax regime which permits unrealized capital gains to permanently escape taxation at death. ACTEC will not opine as to the whether the current tax regime is appropriate and cannot opine as to whether a Deemed Realization Tax would create greater equity. However, in the preceding quotes, the Treasury Department has accurately described the current income tax treatment of

³ 1969 Proposal, page 331.

⁴ 1969 Proposal, page 334.

⁵ 2016 Proposal Joint Committee Report, page 156.

capital assets. Under current law, a taxpayer who retains an appreciated capital asset can escape income taxation altogether on that inherent gain by retaining the asset until death. The inherent gain is never taxed to the taxpayer because the taxpayer has not sold or exchanged the asset, and the gain is not taxed to the taxpayer's beneficiaries because the income tax basis of the capital asset is adjusted to fair market value at the time of the taxpayer's death. As noted in the 1969 Proposal, capital assets have preferential income tax treatment (*e.g.*, a preferential tax rate) under the Internal Revenue Code. The ability to escape income tax on unrealized capital gains if a taxpayer retains the asset until death compounds the preferential treatment given to capital assets.

The 1969 Proposal estimated the amount of revenue that could be raised by implementation of a Deemed Realization Tax at that time. Likewise, the 2016 Proposal Joint Committee Report asserted that the 2016 Proposal would raise substantial revenue without increasing income tax rates or reducing other exclusions, deductions, or credits. ACTEC cannot verify the accuracy of revenue projections and does not take a position as to tax rates, exemptions, deductions, or credits.

Both the 1969 and the 2016 Proposals stress the adverse economic impact caused by the lock-in effect arising from the current income tax treatment of capital assets. Presumably, older taxpayers are retaining low-basis capital assets which they would otherwise be inclined to sell because of the substantial tax savings that occurs by retaining those assets until death. According to the Treasury Department, the lock-in effect has a detrimental impact on the economy. ACTEC cannot opine on the economic impact of the lock-in effect. However, members of ACTEC can state that they have observed the lock-in effect. Repeatedly, elderly clients, even when holding substantial concentrations of appreciated assets, refuse to sell them during their lifetimes, waiting for the tax-free upward adjustment to basis that will occur on their deaths. Many of these clients presumably would be more inclined to sell appreciated assets

during their lifetimes if the tax law would impose a Deemed Realization Tax on the appreciation at their deaths.

G. EFFECTIVE DATE FOR APPLICATION OF THE TAX

Under the 1969 Proposal, the Deemed Realization Tax would only apply to appreciation occurring after the enactment of the tax. An example is helpful. Assume a taxpayer owns a capital asset with an income tax basis of \$100,000 and a value of \$200,000 on the date of the enactment of the Deemed Realization Tax, and the taxpayer retains this asset until death, at which time it has a value of \$400,000. Under the 1969 Proposal, a capital gains tax would have been imposed on the \$200,000 of appreciation occurring after enactment of the Deemed Realization Tax. The \$100,000 of appreciation that occurred prior to the law's enactment would not have been subject to the Deemed Realization Tax, and the asset would have had an adjusted basis of \$400,000 to the taxpayer's beneficiaries.

Continuing with the foregoing example, under the 2016 Proposal, all of the unrealized capital gain would be taxed on the taxpayer's death regardless of when the gain occurred. The 2016 Proposal would impose income tax at the capital gain rate on \$300,000 (\$400,000 value at death less \$100,000 basis) of unrealized gains. The Joint Committee, well aware of the tax treatment under the 1969 Proposal, gives the following explanation for the taxation of all of the gain:

“One could argue that the absence of a transition rule raises a question of fairness for taxpayers who have made decisions based on present law to retain appreciated assets in anticipation of death. On the other hand, taxing only appreciation that occurs after the effective date could be administratively complex, requiring a valuation of all property not only at the time of sale, but also as of the effective date of the proposal.”⁶

⁶ 2016 Proposal Joint Committee Report, page 191, footnote 393.

The Joint Committee is correct. A transition rule which would tax only gain occurring after a certain date, would require taxpayers to incur the cost of an appraisal for non-readily marketable assets, such as interests in closely-held entities, real estate, timber, oil and gas working interest and royalties. In addition to the cost of the appraisal of an asset at the time of the enactment of the tax, if the taxpayer retained the asset until death, the taxpayer's estate would be forced to have the asset re-appraised, thereby incurring the cost of a second appraisal. Invariably, disputes would arise between the Treasury and the taxpayer's estate over the accuracy of both appraisals. Currently, the Treasury and taxpayers litigate over the accuracy of appraisals valuing assets as of the date of death, or the alternate valuation date, for estate tax purposes. If the Deemed Realization Tax has a transition rule, the Treasury and the taxpayer would be disagreeing and litigating over two appraisals. Whether the additional appraisal costs and possibility of additional valuation disputes outweigh the equity of a transition rule is debatable. Taxpayers may argue that it is their cost to bear the two appraisals; they are correct. However, the cost to the Treasury and the cost to the judicial system would also need to be considered.

In the foregoing example, note that under both the 1969 and 2016 Proposals, the income tax basis would not be adjusted at the time of the enactment of the new tax. If the taxpayer thereafter actually sells the asset during his or her lifetime, the full amount of the gain would be taxable under both the 1969 and the 2016 Proposals.

When Canada adopted its Deemed Realization Tax, it permitted an adjustment to basis for all capital assets. All assets received an adjustment to basis equal to their fair market value at the time of the law's enactment. Thus, in the foregoing example, a Canadian taxpayer's basis would have been adjusted to the value of the capital asset at the time of the law's enactment, or \$200,000. If the taxpayer later sold the asset or gratuitously transferred it when it was worth

\$300,000, he or she would realize only a \$100,000 capital gain. Significantly however, before the enactment of its new law, Canada did not impose an income tax at all on the sale of a capital asset. Its tax law at the time was significantly different from the current U.S. income tax treatment of capital gains.

H. BASIC AND OTHER EXCLUSIONS

Under the 1969 Proposal, every taxpayer would be deemed to have a minimum basis for property at death of \$60,000 or the property's fair market value, whichever was less. The Proposal provided two examples. If a taxpayer has property with a basis of \$80,000, that basis would be used for deemed realization purposes. If a taxpayer died with an asset with a fair market value of \$35,000 and a basis of \$20,000, no deemed gain would be realized because the taxpayer's basis would be adjusted to \$35,000. Notably, the \$60,000 threshold equaled the exclusion for estate tax purposes at that time. In other words, a \$60,000 estate would not be subject to estate taxes or the Deemed Realization Tax.

The minimum exclusion in the 2016 Proposal represents a sharp contrast. In 2016, estates at or below \$5,450,000 were exempt from transfer taxes. The 2016 Proposal grants decedents a \$100,000 basic exclusion, indexed for inflation, from a deemed realization of gain. The exclusion would apply at the taxpayer's death, but apparently not with respect to gifts. In addition, the 2016 Proposal also provides a \$250,000 exclusion from capital gain on the gratuitous transfer of a personal residence. Currently, IRC §121 excludes \$250,000 of gain on the sale of a taxpayer's principal residence.

Although ACTEC does not take a position as to tax rates, exclusions, deductions, or credits, it would be remiss not to note that under the 1969 Proposal, the basic exclusion for the Deemed Realization Tax equaled the exclusion from estate taxes. Estates with assets having an aggregate value of \$60,000 were not exposed to either tax. As noted in the 1969 Proposal:

“Since every taxpayer would be presumed to have a minimum basis in property transferred at death of \$60,000, only those with significant amounts of assets would be affected by this proposal.”⁷

The exclusion provided in the 2016 Proposal for the Deemed Realization Tax is insignificant compared to the filing threshold for estate taxes. In 2018, less than one tenth of one percent of U.S. resident decedents faced an estate, gift or GST tax due to the filing threshold of \$11,180,000. Very few taxpayers die with estates of that size or greater.⁸ Because of this filing threshold, very few estates must incur the cost and expense associated with filing estate tax returns. The 2016 Proposal generally excludes only \$100,000 of assets, indexed for inflation, from a deemed realization of gain. The 2016 Proposal would likely result in millions of estates being required to pay additional income tax in the decedent’s final taxable year.⁹

If the 2016 Proposal were enacted, the tax would likely affect millions more taxpayers than are affected by the estate, gift and GST tax law unless the \$100,000 exclusion is substantially increased. Substantially increasing that exclusion, however, would significantly nullify the advantageous elimination of the “lock-in” incentive to retain substantially appreciated property until death, referred to above.

⁷ 1969 Proposal at p. 43.

⁸ In the 2016 Proposal Joint Committee Report, the Joint Committee on Taxation estimated that only about 1,800 out of about 2,700,000 decedents (or 0.067%) expected to die in 2018 would owe any estate tax. This estimate presumably was based on an anticipated estate tax filing threshold of \$5,600,000 in 2018. Since the actual estate tax filing threshold in 2018 was almost double that amount, a much lower percentage of 2018 U.S. resident decedents had taxable estates.

⁹ For example, assume a taxpayer’s principal residence had a basis of \$50,000 and a fair market value of \$500,000 on the date of taxpayer’s death. Unless the exclusion of \$250,000 of gain on the sale of a principal residence under IRC §121 is increased or indexed for inflation, the taxpayer would be deemed to realize a \$100,000 capital gain at that time (\$500,000 minus (1) the \$50,000 basis, (2) the \$250,000 principal residence exclusion, and (3) the \$100,000 basic exclusion).

The 2016 Proposal did not address whether the \$100,000 general exclusion would apply to gifts. Under current estate tax provisions, as indicated above, a taxpayer is granted an applicable exclusion amount¹⁰ which is available for taxable gifts, with any amount unused during lifetime available at the taxpayer's death. In addition, under gift tax provisions, taxpayers are able to gift an amount equal to the annual exclusion amount¹¹ without it being considered a taxable gift. The annual exclusion and the availability of the applicable exclusion amount encourages gifting. Arguably, it would be consistent with Congressional objectives to grant taxpayers an annual exclusion and to use the basic exclusion from the Deemed Realization Tax for lifetime gifting. Any portion of the basic exclusion not used to cover lifetime gifts would be available against the deemed realization of gains at death.

On the other hand, a compelling argument could be made against extending the basic exclusion and annual exclusion for gifts in the Deemed Realization Tax regime. It should be noted that the annual exclusion and the applicable exclusion amount would still be available for gift tax purposes. Taxpayers could still transfer cash and assets with no unrealized gains without a gift tax cost to the extent of the annual exclusion and the amount of their applicable exclusion amount. Secondly, taxpayers are not forced to make gifts and are free to choose which assets to gift. Third, if an annual exclusion and the basic exclusion for the Deemed Realization Tax were permitted for gifts, taxpayers would have an incentive to give assets with significant unrealized gains, because transferring appreciated assets during lifetime would reduce the amount of capital gain that would be realized on the transferred assets if retained until death. Fourth, if the lifetime transfers were within both the annual and basic exclusion amounts, taxpayers would have an incentive to take aggressive valuation discounts on non-readily marketable assets, because if the

¹⁰ In 2019, the applicable exclusion amount is \$11,400,000, indexed for inflation.

¹¹ In 2019, the annual exclusion amount is \$15,000 per donor, per donee, indexed for inflation.

Internal Revenue Service were to audit the returns and revalue the gifted assets, the transfers would still be protected by the basic exclusion.

Congress will need to consider the amount of the basic exclusion and whether it would be available for gifts.

I. BREADTH OF THE APPLICATION OF THE DEEMED REALIZATION TAX

The 1969 Proposal provides that the Deemed Realization Tax would apply to “assets held at death, including assets over which the decedent has a general power of appointment.”¹² The 2016 Proposal references imposing a tax only on the taxpayer’s property. Neither Proposal specifically addresses whether the Deemed Realization Tax would apply to other property that is subject to estate tax at the taxpayer’s death but not owned by him or her at death. Presumably, the new tax would apply to property held in a trust that the decedent could have revoked or amended at any time during his or her lifetime, and also to property held in any other trust that is includable in the decedent’s gross estate for federal estate tax purposes. See *infra* Paragraph Q for a discussion of the application of the Deemed Realization Tax to transfers into and out of trusts. In addition, a decedent’s interest in jointly owned property passing to a surviving joint tenant, or property payable to a beneficiary pursuant to a payable-on-death beneficiary designation, presumably would be subject to the Deemed Realization Tax. Congress will need to address the breadth of the application of the Deemed Realization Tax in this regard.

As noted in the previous paragraph, the 1969 Proposal provides that the tax applies to assets subject to the taxpayer’s general power of appointment. On many occasions, the taxpayer is not the grantor of a trust over which the taxpayer holds a general power of appointment. A trust over which a taxpayer holds a general power of appointment is included in his or her gross estate for federal estate tax purposes under IRC §2041. Arguably, imposing a capital gains tax

¹² 1969 Proposal, page 340.

on assets held in a trust over which the taxpayer is not the grantor but merely holds a general power of appointment is counter to the principle of the new tax, which seeks to impose a capital gains tax on assets owned by the taxpayer. On the other hand, the taxpayer *usually* has been given broad dispositive control over general power of appointment property and therefore it can be argued that the property subject to such a power should be subject to the Deemed Realization Tax.¹³ If the assets are not subject to the Deemed Realization Tax, should they receive an adjustment to basis? Arguably they should, because they are included in the taxpayer's federal gross estate. Congress will need to consider whether the Deemed Realization Tax should apply to property over which the taxpayer holds a general power of appointment.

J. TANGIBLE PERSONAL PROPERTY

Under the 1969 Proposal, any gain on “ordinary personal and household items” of a value of less than \$1,000 would be excluded from the Deemed Realization Tax. The proposal specifically notes that the tax excludes all clothing, drapery, carpeting, furniture, appliances, cars, jewelry, furs, and works of art. It further notes: “For purposes of this rule [\$1,000 exclusion], assets that constitute a set or collection, such as stamps, guns, coins, or works of art, will be treated as a single asset. When it is determined that a set or collection exceeds \$1,000 in value then each item will be valued individually; gain will be recognized on individual items in the set that have appreciated in value and losses due to depreciation in value will be disallowed under usual rules relating to losses of a personal nature.”¹⁴ As to “ordinary personal and household items” with values below the \$1,000 threshold, the transferee would have a basis equal to its fair market value at the time of the taxpayer's death.

¹³ We say “usually” because sometimes the technical scope of what constitutes a general power of appointment under current law extends to power over property that does not appear to be so broad. It might be appropriate to have a narrower definition of this concept if it is used in levying a deemed realization tax.

¹⁴ 1969 Proposal, p. 342.

Under the 2016 Proposal, any gain on “tangible personal property such as household furnishings and personal effects (excluding collectibles),” would be excluded from the Deemed Realization Tax.

The 2016 Proposal is broader than the 1969 Proposal in that it places no limit on the value of the tangible personal property excluded from the Deemed Realization Tax. However, few items of tangible personal property, especially household furnishings, appreciate in value. Those items which tend to appreciate in value will often fall into the category of collectibles.

Excluding the entire category of tangible personal property, other than collectibles, from the tax eliminates the need for costly appraisals to verify that the value is below basis. In addition, it avoids the burden of taxpayers verifying basis on assets where receipts are typically not retained. Congress may wish to consider placing a threshold dollar amount under which collectibles will not be subject to the tax. For example, under the 2016 Proposal, a stamp collection with an estimated value of \$10,000 would be subject to an appraisal and possibly the Deemed Realization Tax for a collector whose estate exceeds the overall basic exclusion threshold (\$100,000 in the 2016 Proposal). The idea is to avoid the imposition of the cost of an appraisal, time expended in determining basis, and the accountant cost of adding the information to the taxpayer’s final income tax return, on amateur collections that have a value below a certain dollar threshold. In many cases of this nature, the estate’s compliance cost would exceed the amount of tax revenue generated by taxing small collections.

K. PERSONAL RESIDENCES

Personal residences have long received preferred tax treatment under the Internal Revenue Code. In the 1969 Proposal, the Treasury argued that a separate exception for personal residences was not needed given “the \$60,000 exclusion [referenced *supra* in Paragraph H], the

100% marital exclusion, and the orphan exclusion,¹⁵ most intra-family transfers of personal residences would be excluded from tax.”¹⁶

The 2016 Proposal provides a \$250,000 exclusion from capital gain on the gratuitous transfer of a personal residence, as if it had been sold for its fair market value as of the date of the transfer. Currently, IRC §121 excludes \$250,000 of gain on the sale of only a taxpayer’s *principal* residence, i.e., not all personal residences.

To remain consistent with the preferential tax treatment Congress has always given to taxpayers’ personal residences, Congress should address the appropriate manner to protect personal residences (or at least the taxpayer’s principal residence) from a forced sale if a Deemed Realization Tax were enacted. The Canadian deemed realization tax generally excludes all gain with respect to a principal residence.

L. MARITAL EXCLUSION

Consistent with the preferential treatment provided in the gratuitous transfer tax regime for transfers to spouses, the 1969 and the 2016 Proposals exempt assets transferred to a spouse from a deemed realization of capital gains. In both proposals, the taxpayer’s gift of appreciated assets to the taxpayer’s spouse would not give rise to a deemed realization of gain. At death, bequests to a surviving spouse also would be excluded from a deemed realization of gain. For both gifts and bequests, the spouse would take a carry-over basis for the transferred assets for all purposes.

While in most cases deferral of deemed realization on property transferred to a spouse will be beneficial, in some cases, realization of all or part of the gain may be optimal for the spouse. The 1969 Proposal provides:

¹⁵ 1969 Proposal, pp. 343 – 344.

¹⁶ 1969 Proposal, p. 342.

“In the case of some form of outright interest passing to a transferee spouse, an option will be made available to have taxed any portion of the property passing under the marital deduction at the time of the transfer. A step up in basis would, of course, accompany this event. The election to be taxed will be exercisable by the transferor and, in the case of a transfer at death, if the transferor makes no election, then by the transferee spouse.”¹⁷

The 2016 Proposal did not address an election of this nature.

Congress should consider the wisdom of permitting an election into the Deemed Realization Tax on a gift or a bequest to a spouse. Because taxpayers have had difficulty making tax elections in the past, however, in crafting a tax election, Congress should take those difficulties into account.

Both Proposals clearly exclude outright transfers of property to a spouse from the Deemed Realization Tax. The 1969 Proposal provides:

“The marital exclusion under the income tax proposal will correspond to the unified transfer tax provisions so that on transfers that qualify for the transfer tax marital exclusion, no gain will be recognized on the appreciation in value of property passing to the surviving spouse at death. Thus, gain will be exempt on any property (1) that passes outright to a spouse (either during life of the transferor spouse or at his or her death), or (2) that passes subject to any kind of legal arrangement assuring the transferee spouse for life or for any other period of time the enjoyment or use of such property, or the income from it, or the right, through the exercise of an unrestricted power vested solely in the transferee spouse, to such outright ownership, enjoyment, use, or income, if the transferee spouse consents to having the termination of such limited interests treated as a taxable transfer by him or her. If the transferee spouse does not receive outright ownership, then a taxable transfer occurs on termination of the transferee’s interest.

“To protect the transferee spouse from liability from tax on property not subject to his or her control or power of disposition, the tax imposed on the gain at termination of one of the kinds of limited interest that is sufficient to qualify property for the marital exemption will be collectible only out of such property.”¹⁸

In 1969, the estate and gift tax marital deductions were available for transfers to a trust in which the spouse was entitled to all the trust’s income, distributions could not be made to any

¹⁷ 1969 Proposal, p. 343.

¹⁸ 1969 Proposal, p. 343.

other person during the spouse's lifetime, and over which the spouse had a testamentary or lifetime general power of appointment, known as a "Marital GPOA Trust." In addition, the gift and estate tax marital deductions were available for transfers to a trust of a similar nature but rather than the spouse having a general power of appointment, the trust was to be distributed to the spouse's estate, known as a "Marital Estate Trust."¹⁹

The quoted language from the 1969 Proposal permits property passing outright to a spouse or into a marital trust to be exempt from a deemed realization of gain. Notably, there would have been a requirement that on the termination of the surviving spouse's interest in such a trust, a deemed realization of gain would occur, and the tax on that gain would be paid by the trust rather than by the surviving spouse.

The 2016 Proposal does not address whether transfers of property to a marital trust will be excluded from the Deemed Realization Tax.

To provide consistency with the federal transfer tax regime, capital assets gifted or passing at death to a trust that qualifies for the gift or estate tax marital deductions (*i.e.*, a Marital GPOA Trust, a Qualified Terminable Interest Property ("QTIP") Trust, and a Marital Estate Trust) should not be subject to a Deemed Realization Tax; and any such trust (a "Marital Trust") should receive the assets with a carryover basis from the taxpayer.

Congress also will have to address whether the Deemed Realization Tax should apply on the termination of the spouse's interest in a Marital Trust. Arguably, the Deemed Realization Tax should apply on the spouse's death as to assets held in a Marital GPOA Trust and a Marital Estate Trust because the spouse had dispositive control over the assets in the trust. The spouse's interest is comparable to that of a beneficiary possessing a general power of appointment in a

¹⁹ A marital exclusion for a Qualified Terminable Interest Trust (QTIP) was not enacted until 1982.

trust created by someone other than the power holder. *See* the discussion of GPOA Trusts in Paragraph I, *supra*. In fact, it is consistent with the concept of the marital unit to defer the deemed realization of gain on the transfer by the first spouse but to impose the Deemed Realization Tax on the death of the other spouse of the marital unit. There seems to be little need to require the spouse to consent to the tax deferral and tax imposition on his or her subsequent death as to Marital GPOA and Marital Estate Trusts. Arguably, the assets in a Marital Estate Trust should be deemed to have been owned by the surviving spouse at death since the Marital Estate Trust property passes to the estate of the surviving spouse. But, if the Deemed Realization Tax applies only to assets owned by a taxpayer at death, then the tax would not apply to the assets in the Marital Estate Trust because at the time of the spouse's death, the assets are owned by the Marital Estate Trust, not the spouse. Thus, the Deemed Realization Tax will need to specifically provide that the assets of a Marital Estate Trust are subject to the tax on the spouse's death.

Transfers to a QTIP Trust are not subject to gift or estate taxes. Upon the cessation of the spouse's interest either during his or her life or on his or her death, the trust property is subject to gift or estate tax. Exposure to taxation under the gratuitous transfer tax regime (exposure may not result in transfer taxes actually being payable) occurs when both spouses (the taxpayer and the taxpayer's spouse) no longer have an interest in the property. As noted *infra* at Paragraph P, a compelling argument can be made that the Deemed Realization Tax should contain provisions that parallel those in the transfer tax regime. If the same tax principles in the transfer tax regime were to be applied to the Deemed Realization Tax, the transfer of assets to a QTIP trust (either during the taxpayer's lifetime or at death) should not cause the assets to be taxed under the Deemed Realization Tax. However, the cessation of the spouse's interest in the QTIP trust,

during his or her lifetime or at death, should cause the assets of the QTIP trust to be subject to the Deemed Realization Tax.

As noted *supra* in this Paragraph L, Congress should consider the wisdom of permitting an election into the Deemed Realization Tax when assets are gifted or devised either outright to a spouse or into a Marital Trust.

Transfers of appreciated property to an irrevocable trust of which the transferor's spouse is a beneficiary but that does not qualify for the federal gift or estate tax marital deduction should be subject to a deemed realization of gain and be treated in the same manner as discussed *infra* in Paragraph Q(1)(c). For example, a trust that authorizes payments of income or principal, during the spouse's lifetime, to a beneficiary other than the spouse, does not qualify for the gift or estate tax marital deduction. Therefore, property transferred to such a trust should be subject to the Deemed Realization Tax on the date of the transfer, and deferment of the deemed realization of gain until the surviving spouse's death should not be permitted.

Property transferred from one spouse to another incident to a divorce probably should take a carryover basis, although an election to incur a Deemed Realization Tax might be allowed.

M. CHARITABLE EXCLUSION

Both the 1969 and 2016 Proposals exempt transfers to charity from the Deemed Realization Tax. Thus, appreciated assets could be transferred to charity without a deemed realization of capital gains. The 1969 Proposal addresses whether a gift to a split-interest charitable lead or remainder trust would be exempt from the new tax as follows:

“Where a transferor creates a split interest (that is, a trust to pay the income to the transferor's son for life, with the remainder to the X charity, or vice versa), the portion going to the charity will qualify for the exemption....”²⁰

²⁰ 1969 Proposal, p. 344.

“For example, if a donor gives a life interest in certain property to A with a remainder to X charity, and the life interest is determined to be equal to 40 percent of the value of the property and the remainder 60 percent to charity, then 40 percent of the gain from the appreciation in the property would be subject to income tax and 60 percent would be exempt under the charitable exception. (This same procedure will be followed with respect to bequests of present and future interests in property transferred at death).”²¹

The 2016 Proposal does not address whether transfers to a trust in which charity is a beneficiary also will be excluded from a deemed realization of gain.

The 1969 Proposal would require that a percentage of the unrealized gain be realized when appreciated assets are gifted to a charitable lead annuity trust (“CLAT”), a charitable lead unitrust (“CLUT”), a charitable remainder annuity trust (“CRAT”), and a charitable remainder unitrust (“CRUT”). Likewise, a percentage of the assets passing into such a trust at death would be subject to the Deemed Realization Tax. The 2016 Proposal does not discuss transfers to any type of trust.

For example, assume that D dies owning Blackacre (a vacant parcel of real estate) valued at \$1,000,000 with a basis of \$100,000. D’s will devises D’s entire estate to a CRUT, providing annual distributions of a unitrust percentage to D’s daughter for her life with the remainder to charity. Assume further that the actuarial value of the charitable interest on D’s death is 10% of the value of the assets passing to the CRUT, which in this example is \$100,000 (10% x \$1,000,000). Under the 1969 Proposal, 10% of the \$900,000 appreciation, or \$90,000, would be excluded from the Deemed Realization Tax. The remaining 90% of the \$900,000 appreciation, or \$810,000, would be subject to the Deemed Realization Tax.

Imposing a Deemed Realization Tax on assets transferred to a charitable split-interest trust would discourage transfers to those trusts. Often taxpayers intentionally transfer assets with unrealized gains to CRATs and CRUTs because the gains realized on sale of the asset by those

²¹ 1969 Proposal, pp. 348 – 349.

trusts will not be currently taxed. While the same percentage rule referred to in the previous paragraph would still apply, exposing a portion of the gain to tax on transfer to the trust would discourage some taxpayers from establishing the trust. Congress should consider the impact the new tax would have on these charitable trusts. To avoid this disincentive, Congress may wish to consider exempting all assets transferred to a CRAT and CRUT from the Deemed Realization Tax as under current law.

While Congress also should consider exempting all assets gifted or passing on the taxpayer's death to a CLAT or CLUT from the Deemed Realization Tax on the initial funding, a Deemed Realization Tax could be imposed on the then unrealized gain upon termination of the charitable lead interest. The taxpayer in the case of a gift, or the executor in the case of a testamentary transfer, could be given the option of electing into the Deemed Realization Tax regime on initial funding and may wish to do so if the taxpayer has losses to offset the gain.

If the taxpayer has a retained interest in a split-interest charitable lead or remainder trust, the deemed realization treatment must be different from the treatment discussed in the preceding paragraphs because the retained interest has not been gifted. One cannot make a gift to oneself of course. For example, if the taxpayer gifts assets to a CRUT, retaining the right to the unitrust interest for life or a term of years, the taxpayer's retained unitrust interest is not considered a gift. If on the taxpayer's death or expiration of a term of years, the trust assets pass to charity, then a deemed realization should not occur on the transfer of the assets to the CRUT or upon the taxpayer's death or the expiration of the term of years, because the taxpayer's retained interest is not a gift and the balance passes to charity. This result is justifiable because these trusts are currently used to defer the tax on capital gains by transferring low basis assets to those trusts and then having the trusts sell the asset. However, those gains, along with the trust's current income, would be taxed to the taxpayer on receipt of the annuity or unitrust payments.

CLATs and CLUTs are now utilized by taxpayers to reduce the value of the transferred property for transfer tax purposes by the present actuarial value of the charitable lead interest in such trusts. The charitable gift and estate tax deductions are available only for transfers to trusts meeting specific statutory requirements. In some cases the actuarial value of the charitable lead interest will equal the entire value of the property transferred. To eliminate this possibility, Congress may want to provide that the actuarial value of the non-charitable remainder interest in a CLAT or CLUT is at least a certain percentage threshold, *e.g.*, 10 percent of the initial net fair market value of the property transferred to the trust, as is now the case under IRC § 664(d)(1)(D) and (2)(D) with respect to the charitable remainder interest in a CRAT or CRUT.

N. OPERATION OF MARITAL AND CHARITABLE EXCLUSIONS WHEN A PORTION OF THE PROPERTY PASSES TO OTHERS

As discussed in Paragraphs L and M, *supra*, the 1969 and 2016 Proposals exempt transfers of property to a spouse or charity from the Deemed Realization Tax. For example, assume that D and D's spouse own Blackacre, a parcel of vacant real estate, as joint tenants with right of survivorship, with a fair market value of \$1,000,000 and a basis of \$500,000; and on D's death, Blackacre vests solely in D's spouse by operation of law due to her surviving D. Under the Proposals, due to the marital exclusion, the inherent capital gain in Blackacre would not be subject to the Deemed Realization Tax on D's death. In this example, it's clear that Blackacre passes to D's spouse, just as it would if D alone owns Blackacre and dies with a will specifically devising it to his spouse. In both cases, D's spouse is entitled to receive Blackacre, and under the Proposals the gain is not realized because of the marital exclusion.

Now assume that D dies owing Blackacre and Greenacre, and Greenacre also has a fair market value of \$1,000,000 but a \$900,000 basis. In this expanded example, assume further that D dies with a will devising D's entire estate in equal shares to D's spouse and D's daughter. In

this expanded example, at the time of D's death, and perhaps even at the time that D's final income tax return is due, D's executor will not have determined which assets will pass to D's spouse and which will pass to D's daughter. D's executor could allocate a one-half interest in each property to D's spouse and D's daughter, or instead, D's executor could allocate one parcel to D's spouse and one parcel to D's daughter, assuming that both parcels were still of equal value.

Under the 1969 Proposal, one half of the gain with respect to each parcel would be subject to the Deemed Realization Tax; and because the entire gain is \$600,000 (a \$500,000 gain on Blackacre and a \$100,000 gain on Greenacre), D's final income tax return would report \$300,000 of gain (\$600,000 of gain, only one half of which is deemed realized because half of the estate passes to D's spouse), regardless of which assets actually pass to D's spouse and to D's daughter.²² In that case, the total basis of the parcel(s) passing to each beneficiary would be \$850,000 (1/2 of \$500,000 + \$900,000 + \$300,000).

Another possible rule would make the deemed realization of gain instead depend on which parcel(s) pass to each beneficiary. For example, if D's executor distributes Blackacre to D's spouse, D's final income tax return would reflect the realization of only \$100,000 of gain because Greenacre passes to D's daughter. In other words, post-mortem planning would be allowed to minimize the amount of deemed realization at D's death. The same post-mortem planning opportunity would arise if a portion of D's estate passes to charity. Congress will need to address the application of the Deemed Realization Tax when only a portion of the estate or trust passes to a spouse or charity. One method of doing so is set forth in EXHIBIT E attached hereto.

²² The 2016 Proposal does not address this issue.

O. LIQUIDITY ISSUES

The Deemed Realization Tax will not result in liquidity issues for those estates comprised solely or substantially of cash and/or readily marketable securities. However, the Deemed Realization Tax may cause liquidity issues for those estates holding substantial interests in non-readily marketable assets (such as closely-held businesses, commercial real estate, art collections, intellectual property, and timber, ranch and farm land) with substantial unrealized gains.

Recognizing the liquidity issues that could arise, the 1969 Proposal would have extended the provisions of Internal Revenue Code IRC §§6161 and 6166 to the additional income tax attributable to the deemed sale of interests in closely held businesses, thereby permitting an extension of time to pay that additional income tax for hardship under IRC §6161 and an installment plan for paying the tax for interests in closely held businesses qualifying under IRC §6166. The 1969 Proposal noted that relief was not needed for deemed realizations of gain occurring on a gift because the taxpayer is not forced to make a gift. In other words, it warned the taxpayer to be in a position to pay the Deemed Realization Tax before making the gift.

The 2016 Proposal provided that the payment of tax on the appreciation of a small family-owned and family-operated business would not be due until the business is sold or ceases to be family-owned and operated, but it did not define the term “small family-owned and family-operated businesses.”²³ It is not clear whether this deferral would be available only with respect to transfers at death. The 2016 Proposal allowed the tax attributable to the deemed sale of other non-readily marketable assets transferred at death to be paid over a 15-year period at a fixed rate of interest.

²³ The 2016 Proposal also provided that the partial exclusion under IRC §1202 for capital gain with respect to the sale of certain small business stock would be applicable.

Both Proposals recognized the illiquidity issues that may arise due to the Deemed Realization Tax. Extending IRC §6161 treatment would provide some relief to estates facing illiquidity issues when the assets in the estate do not qualify for IRC §6166 (and even when the assets do qualify, to the extent illiquidity remains).

IRC §6166, or an extension of time to pay, should be extended to the Deemed Realization Tax. Congress may want to adopt the definition of an interest in a closely held business set forth in IRC §6166 with respect to the estate tax. By adopting a similar standard, the confusion and complications that arise by having two different standards for closely held businesses would be avoided. In addition, by adopting the same standard as set forth in IRC §6166, the Treasury Regulations, Treasury announcements and case law under §6166 can serve to assist taxpayers and the Treasury in administering the new tax. In the alternative, Congress could adopt legislation that would permit relief to a broader range of small family-owned and family-operated businesses than current §6166, coupled with amending §6166 to mirror the provisions relating to the new tax in order to provide parallelism, as proposed *infra* in Paragraph P. By adopting a single definition for small family-owned and family-operated businesses for the Deemed Realization Tax and the estate tax, Congress would provide simplicity and ease of administration.²⁴

Congress may wish to exempt a decedent's interest in small family-owned and family-operated businesses and other closely held entities from the Deemed Realization Tax altogether if the interest passes to, or in trust for the benefit of, one or more of the taxpayer's family members. If so, Congress presumably would provide that the family members receive a carryover income tax basis rather than a fair market value basis. The family would then

²⁴ Furthermore, the definitional rules under § 6166 could be revised and simplified.

recognize the gain when the interest no longer meets the definition of a small family-owned and operated business or when it is sold. The Canadian deemed realization tax provides similar treatment for such businesses.

P. PARALLELISM

In the 1969 Proposal, the Treasury Department emphasized that the Deemed Realization Tax would work in parallel with the existing gratuitous transfer tax law, providing that “[t]he marital exclusion under the gain proposal will correspond to the unified transfer tax provision. No gain will be recognized on the appreciation in value of property passing to the surviving spouse at death which qualifies for the transfer tax marital exclusion.”²⁵ Likewise, the Treasury Department noted that the “[p]resent rules for payment of taxes due at death for those estates that have liquidity problems will be liberalized, and the new rules will apply to capital gains taxes as well as transfer taxes.” In the 1969 Proposal, the Treasury Department manifested its desire to have parallel provisions in the gratuitous transfer tax and Deemed Realization Tax laws. It is important that any legislation imposing a tax on a deemed realization of gain on a gift or at death be coordinated with the existing gratuitous transfer tax laws to avoid unnecessary complications and confusion. To avoid two incompatible statutes, it is crucial that the exemption for transfers to spouses or charity from a deemed realization of gain generally parallel the gift and estate tax marital and charitable deductions. By crafting parallel statutes, Congress would ensure that any gift or bequest qualifying for the gift or estate tax marital or charitable deduction also will be exempt from a deemed realization of gain. Likewise, the special tax deferral provisions concerning small businesses in the Deemed Realization Tax should work in parallel with the gratuitous transfer tax regime. If a small business qualifies for deferral of tax payment with respect to the Deemed Realization Tax, it should be granted an identical deferral for transfer

²⁵ 1969 Proposal, at p. 337.

taxes. Parallelism can occur by ensuring that any new deemed realization of gain provisions generally mirror the provisions of the current transfer tax law or by amending the current transfer tax provisions to mirror those of any new deemed realization statutes.

Q. APPLICATION OF THE DEEMED REALIZATION TAX TO TRANSFERS INTO AND OUT OF TRUSTS

The 1969 Proposal addresses transfers to a Marital Trust and to a charitable split-interest trust; the 2016 Proposal does not. As indicated earlier, the application of the Deemed Realization Tax on the transfer to trusts of capital assets with unrealized gains presents numerous issues. The first issue to be addressed is whether any gain will be realized when an appreciated asset is transferred to a trust if the taxpayer retains a power over or an interest in the trust, especially if the retained power or interest results in the assets later being included in the taxpayer's federal gross estate. The second issue to be addressed is whether gain will be realized when an appreciated asset is transferred into a trust of which the transferor's spouse or charity is a beneficiary. Thirdly, consideration must be given to whether the Deemed Realization Tax applies to transactions between a taxpayer and a trust of which the taxpayer is the grantor for federal income tax purposes (a "Grantor Trust"). Finally, any proposal should address whether long-term trusts should be subjected anew to a Deemed Realization Tax on the occurrence of certain events or the passage of a certain period of time.

1. Imposition of the Deemed Realization Tax on Transfers to a Trust

(a) Revocable Trusts

Revocable trusts are commonly used in the estate planning process to assist in the administration of a taxpayer's assets during periods of incapacity and to reduce the need for probate after the taxpayer's death. The 1969 and 2016 Proposals both would have imposed the Deemed Realization Tax on a completed gift. A completed gift does not occur

when assets are transferred to a revocable trust because of the taxpayer's retained revocation power. Therefore, under both Proposals, a taxpayer's transfer of assets to a revocable trust would not result in a deemed realization of gain or loss because a completed transfer has not occurred. Likewise, the taxpayer's transfer of assets to an irrevocable trust will not give rise to a deemed realization if the taxpayer retains the right to change the beneficiaries of the trust or any other power that prevents a completed gift from occurring. The Deemed Realization Tax should apply to a transfer only when a completed gift occurs.

See *infra* Paragraph Q(2)(a) for an analysis of the imposition of the Deemed Realization Tax if the taxpayer retains the power to revoke the trust at the time of death.

(b) Retained Powers or Interests in Irrevocable Trusts

If the taxpayer transfers assets to an irrevocable trust and retains solely the right to receive the income of the trust for life or a period of years (known as a Grantor Retained Income Trust or "GRIT"), the retained income interest generally is not considered a gift. However, the taxpayer is deemed to have made a completed gift of the remainder interest in the trust. The actuarial value of the retained income interest is subtracted from the value of the assets transferred to determine the value of the remainder interest. The value of the remainder interest would be the value of the amount gifted. To prevent perceived abuses, Congress enacted IRC §2702 in 1990. IRC §2702 provides that in valuing a remainder interest when a family member is a beneficiary of the trust, the value of the taxpayer's retained interest is deemed to be zero unless the retained interest is a "qualified interest." Applying this tax provision to the foregoing GRIT example, the retained income interest would be deemed to have a value of zero if a family member is a beneficiary of the trust, because the retained income interest fails to meet the definition of a "qualified interest." Under current law, a taxpayer who wishes to retain a present interest in a trust with family members as remainder beneficiaries now establishes a

Grantor Retained Annuity Trust (a “GRAT”), a Grantor Retained Unitrust (a “GRUT”), a Personal Residence Trust (a “PRT”), or a Qualified Personal Residence Trust (a “QPRT”), because the retained interests in these trusts are considered qualified interests and reduce the value of the gift. GRITs are still used by taxpayers when all the remainder beneficiaries of the trust are non-family members.

Congress will need to address the application of the Deemed Realization Tax to transfers in trust that constitute in part a completed gift. Congress could include a provision parallel to IRC §2702 in the Deemed Realization Tax. If so, the Deemed Realization Tax would be imposed on all the assets transferred to a trust with family members as remainder beneficiaries unless the retained interest is a qualified interest. If the retained interest is a qualified interest, the value of the retained interest would reduce the amount gifted. The remainder interest considered gifted (*i.e.*, the value of the remainder interest) would be subject to the Deemed Realization Tax. For example, if the taxpayer established a GRAT with family members as remainder beneficiaries and the value of the retained interest was 90% of the value of the assets transferred, then the taxpayer would be deemed to have made a taxable gift equal to 10% of the value of the assets transferred, and 10% of the unrealized capital gains would be realized. The basis of the assets transferred would be adjusted for the 10% of the gain realized, with the remaining 90% of those assets retaining a carryover basis. If the qualified interest had a value equal to 100% of the amount transferred, the remainder interest would be valued at zero for gift tax purposes and no Deemed Realization Tax would be imposed, unless the law provided that the actuarial value of the remainder interest is at least a certain percentage, *e.g.*, 10 percent of the initial net fair market value of the property transferred to the trust, as discussed at the end of Paragraph M, *supra*, with respect to CLATs and CLUTs.

Congress could, of course, adopt a different rule for purposes of the Deemed Realization Tax from that of the current gift tax. For example, it could provide that the gain should be determined in the manner that retained interests were valued before the adoption of IRC §2702. Thus, the retained income interest in a GRIT would not be considered a taxable gift, and no Deemed Realization Tax would occur with respect to the portion of the amount transferred that represents the retained interest.

Current law provides that a taxpayer's allocation of Generation-Skipping Transfer Tax Exemption ("GST Exemption") is not effective during the estate tax inclusion period ("ETIP"). Congress could adopt a similar rule with respect to the Deemed Realization Tax, in which case a Deemed Realization Tax would only be incurred at the end of the ETIP.

Alternatively, the Deemed Realization Tax could permit a taxpayer to elect to treat the entire amount transferred to a trust with a qualified retained interest as subject to the Deemed Realization Tax at that time, with a corresponding provision that, if such an election is made, the Deemed Realization Tax would not be imposed on the termination of the retained interest or on the taxpayer's death should the taxpayer die during the term of the retained interest.

Congress should consider the impact that would occur if the provisions of the Deemed Realization Tax are different from those of the gift tax. A compelling argument can be made for parallel rules, as argued *supra* in Paragraph P, which means the Deemed Realization Tax would mirror the current gift tax law or the current gift tax provisions would be modified to match those of the Deemed Realization Tax.

(c) Irrevocable Trusts with No Taxpayer Retained Powers or Interests

Taxpayers often establish irrevocable trusts without retaining powers or interests. This Report considers the application of a Deemed Realization Tax to Marital Trusts

supra in Paragraph L and to Split-Interest Charitable Trusts *supra* in Paragraph M. All or part of the unrealized gain with respect to the assets transferred to those trusts would be exempt from the Deemed Realization Tax. Transfers to irrevocable trusts over which the taxpayer has not retained any powers or interests and which do not qualify for the marital or charitable deduction, should be subject to the Deemed Realization Tax if a tax of this nature is adopted. Transfers to such trusts should be treated in the same manner as outright transfers.

Now that we have explored whether and to what extent a Deemed Realization Tax should apply to transfers to trusts, we will shift our focus to the question of whether the assets in the trust should later be subject to a Deemed Realization Tax. Note, the imposition of a Deemed Realization Tax on the initial transfer of assets to the trust does not necessarily imply that the trust assets should never be subject to the Deemed Realization Tax again. Likewise, the non-imposition of a Deemed Realization Tax on the initial transfer does not require that the tax should not be applied to the assets of the trust at a later time.

2. Imposition of the Deemed Realization Tax on Termination of the Taxpayer's Retained Powers or Interests

(a) Retained Power of Revocation Held at Death

At a minimum, the Deemed Realization Tax generally should be imposed on the taxpayer's death as to assets held in the taxpayer's revocable trust if the taxpayer dies holding the revocation power. The revocation power would expose the value of the assets in the Revocable Trust to inclusion in the taxpayer's federal gross estate pursuant to IRC §2038 and likewise should require the assets to be subject to the Deemed Realization Tax. If the assets in the taxpayer's Revocable Trust are not subject to the Deemed Realization Tax, a loophole would be created which would permit taxpayers to avoid paying the Deemed Realization Tax by transferring assets to a Revocable Trust. Because the assets in a revocable trust are not subject to

a deemed realization on their transfer to the trust (because a completed gift does not occur at the time of the transfer), the Deemed Realization Tax would be avoided entirely unless it is imposed at the taxpayer's death. Note, if the taxpayer relinquishes the revocation power during life, retaining no other power or interest in the trust that would prevent a completed gift from occurring, then a deemed realization should arise at that time. In addition, any gratuitous transfers of assets from a revocable trust during the taxpayer's lifetime to someone other than the taxpayer, the taxpayer's spouse, or charity, should likewise be subject to the Deemed Realization Tax.

(b) Other Retained Powers or Interests Held in an Irrevocable Trust at Death

Congress will need to address whether the Deemed Realization Tax will be imposed on the assets in an irrevocable trust if the taxpayer created the trust and retained a power or interest in it, other than a power of revocation, that would subject the assets in the trust to inclusion in the taxpayer's gross estate under one or more of the estate tax inclusionary provisions, *i.e.*, IRC §§2036 through 2038, hereinafter "Estate Inclusionary Powers or Interests." For example, if the taxpayer dies during the period of the retained annuity interest in a GRAT, what portion, if any, of the assets in the GRAT should be subject to a Deemed Realization Tax? Again, a compelling argument can be made for having parallel provisions in the Deemed Realization Tax and the gratuitous transfer tax. Simplicity in the tax code is one of the objectives often sought by Congress and parallel provisions would further that objective.

(c) Irrevocable Trusts with No Retained Powers or Interests

As noted *supra* in Paragraph Q(1)(c), transfers to a trust in which the grantor has not retained a power of revocation or any other Estate Inclusionary Powers or Interests should be fully subject to the Deemed Realization Tax, because the transfer is a

completed gift as to all of the assets transferred. The assets transferred to a trust of this nature should then receive an adjustment to their income tax basis. Because the taxpayer has not retained a power of revocation or any other Estate Inclusionary Powers or Interests, the assets should not be subject to the Deemed Realization Tax at the time of the taxpayer's death. *See infra* Paragraph Q(4) for the treatment of Long-Term Trusts.

3. Grantor Trust Rules

To prevent abuses, Congress needs to address how the grantor trust rules in IRC §§671 through 679 would apply to a Deemed Realization Tax. Under those rules, the income earned by a Grantor Trust is treated as being the grantor's income, and transactions between the grantor and the Grantor Trust are disregarded for income tax purposes. The applicability of the Deemed Realization Tax to the transfer of assets to an irrevocable trust with retained Estate Inclusionary Powers or Interests is discussed *supra* in Paragraph Q(2)(b). Rarely, if ever, would a taxpayer sell appreciated assets to a non-grantor trust with Estate Inclusionary Powers or Interests because the value of the assets is subject to estate taxation on the taxpayer's death in the same manner as if the taxpayer retained the asset. However, under current law a taxpayer can establish a Grantor Trust with retained powers or interests that nevertheless will not result in the value of the assets being subject to estate tax inclusion on the taxpayer's death; and if Congress does not address this possibility, such a trust could escape the application of the Deemed Realization Tax.

For example, assume that the enacted Deemed Realization Tax applies on a taxpayer's death if the taxpayer has retained one or more Estate Inclusionary Powers or Interests but the tax does not specifically address the grantor trust rules. Assume, further, that the taxpayer transfers cash to an irrevocable trust, retaining the non-fiduciary power to substitute assets of equal value but not retaining any Estate Inclusionary Powers or Interests, and

subsequently sells highly appreciated property to the trust. In this example, the trust qualifies as a Grantor Trust because of the grantor's non-fiduciary power to substitute assets of equal value, as provided in IRC § 675(4)(D). That power, however, does not result in the assets being subject to estate tax on the taxpayer's death. The cash transferred to the trust will constitute a gift under the gift tax regime but will not result in a Deemed Realization Tax because cash has a basis equal to its value. Because of the grantor trust rules, the asset sale is not considered a taxable transfer. If the Deemed Realization Tax also ignores the sale, the gain attributable to that appreciated property would never be taxed during the taxpayer's lifetime or at the taxpayer's death.

To prevent this perceived abuse, Congress may wish to provide that the Deemed Realization Tax will apply to any appreciated property (1) transferred to a Grantor Trust that will **not** be subject to estate tax on the taxpayer's death; or (2) included in the trust when it ceases to be a Grantor Trust, either during the taxpayer's lifetime or at the latest on the taxpayer's death.

Another alternative would be for Congress to harmonize the grantor trust rules with the Estate Inclusionary Powers or Interests such that a trust will be treated as a Grantor Trust only if the settlor retains one or more Estate Inclusionary Powers or Interests. This would further the goal of parallelism discussed *supra* in Paragraph P.

4. Long-Term Trusts

Congress will need to address how the Deemed Realization Tax will apply to Long-Term Trusts.²⁶ The issue is not whether the assets transferred to a Long-Term Trust should be subject to a Deemed Realization Tax. The issue is whether and when the assets owned by the Long-Term Trust should be subject to the Deemed Realization Tax. The assets at issue may

²⁶ The term "Long-Term Trust" refers to a trust that is drafted to last for a long period of time. The period of time is intentionally not defined herein but generally such trusts are drafted to benefit beneficiaries in more than one generation.

have been contributed by the original settlor, contributed by another party, or purchased by the trustee.

It could be argued that the Deemed Realization Tax should apply only when the assets are initially transferred to the trust, either during the settlor's lifetime or at death. Limiting the Deemed Realization Tax to the initial transfer, however, would permit the avoidance of any additional deemed realization for families who can afford to establish and maintain Long-Term Trusts, while taxpayers and their descendants of more modest wealth generally will be subject to the tax during each generation. Arguments of a similar nature were made in connection with the enactment of the GST tax in 1986.

To address this issue in a manner consistent with the gratuitous transfer tax law, Congress may wish to layer onto the Deemed Realization Tax in Long-Term Trusts the GST tax principles of "taxable distributions," "taxable terminations," "skip persons" and "non-skip persons." Under this alternative, property distributed from a Long-Term Trust to a non-skip person would not result in a deemed realization, but property distributed to a skip person (a taxable distribution) would result in a deemed realization; and a deemed realization would occur with respect to all of the trust property at such time as all of the trust beneficiaries are skip persons (a taxable termination).²⁷ Imposing a Deemed Realization Tax on the death of the last survivor of one generation was discussed in the 1969 Proposal.²⁸

If the GST tax is used as a model, Congress may wish to consider whether trusts that are exempt from the GST tax, commonly referred to as GST tax-exempt trusts and effective-date trusts, should be exempt from any deemed realization event. If so, trusts that are wholly or

²⁷ In a partial taxable termination, only part of the trust assets would be subject to a deemed realization or possibly a fractional portion of all of the trust assets would be subject to a deemed realization.

²⁸ 1969 Proposal, pp. 339 and 349 – 350.

partially exempt from the GST tax also would be wholly or partially exempt from any deemed realization of gain or loss.²⁹

R. INCOME IN RESPECT OF A DECEDENT (“IRD”) - INSTALLMENT OBLIGATIONS AND DEFERRED COMPENSATION

The 1969 Proposal would have applied the Deemed Realization Tax to IRD so that all IRD items would be taxed on the decedent’s death, and to avoid bunching problems, averaging rules would apply.³⁰ The 2016 Proposal does not specifically address IRD items. IRD items can include installment obligations to which IRC §453A applies, as well as deferred compensation, both qualified and non-qualified, to which IRC §§ 401 through 436 apply. To avoid hardship, Congress should deal with liquidity issues with respect to both installment obligations and deferred compensation, as discussed in Paragraph O, *supra*.

Taxing deferred compensation to the person who earns it is consistent with the policy of the Proposals to tax unrealized capital gain with respect to gratuitous transfers of property to the person who owned the property when the gain accrued. Similar tax treatment applies to deferred compensation under Canadian law. To avoid the bunching problems referred to above, Congress might want to consider granting the taxpayer’s personal representative an election to spread the taxation of IRD consisting of ordinary income over the taxpayer’s final taxable year and several taxable years prior thereto, for example, the final and previous four taxable years (or possibly the entire period of his or her retirement), with the increased tax liability with respect to all such prior years added to the tax liability with respect to the decedent’s final taxable year. This would be similar to the way in which the throwback tax under IRC §§665 through 667 is imposed and

²⁹ Alternatively, Congress may want to consider how the issue is addressed under the Canadian tax law. Canadian law generally provides that property held in a trust will be deemed to be sold for its fair market value every 21 years after the trust is established, regardless of the date on which any such property is transferred to the trust. Under Canadian law, the deemed realization event is imposed without regard to the actual death of the beneficiaries.

³⁰ 1969 Proposal, pp. 339 and 347.

the way in which lump-sum distributions from qualified retirement plans to participants were taxed under previous tax laws. To be consistent, Congress may wish to exclude that portion of deferred compensation payable to the taxpayer's spouse and charity from tax.

S. REPORTING OF DEEMED REALIZATION TAX

Under the 1969 Proposal, the capital gain on a deemed realization at death would be reported on the taxpayer's final income tax return.³¹ The 1969 Proposal did not explicitly state on which tax return the gain imposed at the time of a gift would be reported.

Under the 2016 Proposal, the gain attributable to a deemed sale of property during the donor's lifetime would be included on the donor's income tax return for the year during which the gift/deemed sale is made, and the gain attributable to a deemed sale of property as of the date of death would be included on the decedent's final income tax return or on a separate capital gain return.

On the one hand, it would seem best to have all deemed gains and losses reported on the decedent's final income tax return, because generally there would then be no difference between the treatment of gains and losses actually realized and those deemed to have been realized during the decedent's final tax year. However, if all of the deemed gains and losses are reported on a married decedent's final income tax return, the additional gain may adversely impact the surviving spouse if a joint income tax return is filed. For example, the additional gain would increase the amount of the adjusted gross income and thus reduce the amount of deductible medical expenses. This inequitable treatment of the surviving spouse would be compounded by the fact that the assets passing in a deductible manner to the surviving spouse would not realize a gain or loss. Rather, only the transfer of assets generally to children and other loved ones (and not to charity) would result in a deemed realization. Thus, if the deemed gains and losses are

³¹ 1969 Proposal, pp. 335 and 340.

reported on the final joint income tax return, the surviving spouse could be adversely impacted by gains and losses with respect to property passing to someone other than herself.

To address the concerns set forth in the preceding paragraph, a separate return to report capital gains and losses attributable to deemed sales of property at death might be allowed to avoid adverse tax consequences to a decedent's surviving spouse if the spouses file a final joint return for that year.

The best solution might be to provide that, if the decedent's executor and surviving spouse decide to file a final joint income tax return for that year, the decedent alone would be liable for the amount equal to the difference between (1) the tax liability shown on the final return including the gains and losses deemed to have been realized during the decedent's final tax year, and (2) the tax liability shown on the final return excluding such gains and losses.

Under the 1969 Proposal, the due date of the taxpayer's final income tax return would be the same as the estate tax return due date, to wit, nine months after the decedent's death or later if extended. Under the 2016 Proposal, the due date remains the same as current law and would not be tied to the estate tax return due date. Making the due date of the decedent's final income tax return the same as the due date of the estate tax return would enable the personal representative in estates subject to the estate tax to coordinate the appraisal process, and to make coordinating tax elections.

Under the 2016 Proposal, an income tax deduction would be allowed for the full cost of an appraisal of gratuitously transferred property deemed to have been sold. This deduction provides needed relief.

T. CAPITAL LOSSES

1. Deemed Realization of Losses as Well as Gains at Death

The 1969 Proposal would have permitted capital losses to be deemed recognized as well as capital gains on the taxpayer's death. The 2016 Proposal addresses only capital gains and does not address whether a deemed capital loss would be recognized. It would seem appropriate that if the Deemed Realization Tax deems the taxpayer to have sold the taxpayer's capital assets at death, capital losses as well as capital gains should be recognized on the taxpayer's death. As to gifts, however, the related taxpayer rule prohibiting a loss from being recognized on a sale to a family member under IRC §267(a) probably should likewise apply to a gift of depreciated property to a family member, with a carryover basis to the donee.

2. Capital Loss Carrybacks

Under the 1969 Proposal, any deemed excess capital losses that were not used on the taxpayer's final income tax return could have been carried back for the taxpayer's three prior taxable years. Any excess after application of the rule in the preceding sentence, would offset ordinary income earned in the taxpayer's final tax return and then for the three previous tax years, subject to certain limitations.³² The 2016 Proposal did not provide similar relief. The capital loss carryback provisions in the 1969 Proposal provide needed taxpayer relief and were intended to provide equity to taxpayers with net capital losses.

3. Actual Unused Capital Losses and Loss Carryforwards

Under both the 1969 and 2016 Proposals, a decedent's actual (versus deemed) unused capital losses and loss carryforwards would be allowed against ordinary income on his or her final income tax return.

³² 1969 Proposal, p. 341.

4. Portability of Unused Losses

The Internal Revenue Code generally treats married individuals as a single unit for tax purposes. Consistent with this tax treatment, IRC §2010(c) provides for the portability of a deceased spouse's unused applicable exclusion amount for estate and gift tax purposes to be made available to the surviving spouse, a concept known as "portability." The 2016 Proposal also would allow portability of any unused portion of the \$250,000 exclusion on gains realized on the sale of a principal residence and the additional \$100,000 exclusion. To effectuate the manifest Congressional policy of generally treating spouses as a single marital unit, Congress should consider allowing the portability of a decedent's actual and deemed unused net capital loss and net operating loss (that is unused after application of reduction in the taxpayer's final return and after application to any carryback provisions) in the same manner. This would be more consistent with the carryover basis for property transferred to spouses, described in Paragraph L, *supra*.

U. SPECIAL VALUATION RULES

To minimize transfer taxes, taxpayers currently engage in planning to reduce the value of assets by certain techniques. To curb what was perceived as abusive valuation techniques, Chapter 14 was added to the Code. Taxpayers have the same motivation to reduce values with respect to the Deemed Realization Tax as in valuing assets for transfer tax purposes. Congress may want to apply Chapter 14 to the valuation of assets for purposes of the Deemed Realization Tax.

V. MISCELLANEOUS MATTERS

1. Estate Tax Deductibility of Deemed Realization Tax

Under both the 1969 and 2016 Proposals, the tax imposed on gains deemed realized at death would be deductible for estate tax purposes. The tax imposed on gains deemed

realized by the donor with respect to lifetime gifts also would, in effect, be excludable or deductible for estate tax purposes, whether the tax is paid before or after the donor's death.

2. Alternate Valuation Date Election

The executor of a decedent's estate may elect to value the assets included in the gross estate based on the value of the assets six months after the decedent's death if the election reduces the amount of the estate tax. This election, set forth in IRC §2032A and known as the "alternate valuation date election," was enacted to reduce the burden of the estate taxes when the estate assets have decreased in value during the six-month period after the date of death. The Code section was enacted to minimize the hardship resulting from the decrease in value. Based on the same rationale, to provide relief from a decrease in value during that period for estate tax purposes, Congress should consider permitting an election to be made on the decedent's final income tax return for the executor to value the assets on the alternate valuation date for purposes of the Deemed Realization Tax. If the election is made with respect to one tax, it probably should be required with respect to the other tax. The 1969 Proposal would have permitted an executor to elect either the date of death value or the alternate valuation date value for the Deemed Realization Tax. The 2016 Proposal was silent on the issue.

3. Holding Period

In the 1969 Proposal, long-term capital gain treatment would have been available regardless of the length of time the decedent held the property. This relief would not have been available on gifts. Presumably, this hardship relief was recommended since taxpayers are unable to determine the timing of their deaths but can choose to delay making a gift until the required holding period for capital gain treatment has occurred. The 2016 Proposal did not grant similar relief.

Providing relief from the holding period requirement for long-term capital gain treatment is equitable in the death context. Congress may wish to consider such relief were it to enact a Deemed Realization Tax.

4. Waiver of Penalty for Underpayment of Estimated Tax in Final Year

Under the 2016 Proposal, there would be a waiver of the penalty for any underpayment of estimated tax with respect to the deemed sale of assets at death. The 1969 Proposal did not provide this relief. However, the relief is equitable because several tax quarters may pass before an appraisal report can be completed to determine the value of difficult assets. In addition, it is often the case that several tax quarters may pass before an estate's personal representative is appointed by a Court.

5. Treasury Rules and Regulations Needed to Implement the Proposal

Under the 2016 Proposal, the Treasury would be granted authority to issue any regulations necessary or appropriate to implement the Proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable. Congress should consider including such authority in any Deemed Realization Tax.

6. Ultimate Liability for Deemed Realization Tax

The decedent's personal representative has a duty to file the decedent's final income tax return reporting the assets with deemed capital gains (and presumably losses). As noted above, that final income tax return will report gains with respect to assets owned by the decedent at death and therefore passing through probate, and most likely on assets owned in joint tenancy with others and passing to them by survivorship, assets held in a revocable trust created by the decedent, and possibly trusts included in the decedent's federal gross estate pursuant to IRC Sections 2036 through 2038 and 2041. Because the return will reflect capital gains on such assets held outside probate, the personal representative should be able to seek recovery of a

portion of the Deemed Realization Tax from the owners of those assets. In other words, Congress may wish to consider granting the personal representative a right to recover a portion of the Deemed Realization Tax from recipients of non-probate property.

For example, assume D dies owning a capital asset with a fair market value of \$1,000,000 and a basis of \$500,000 that passes according to D's will to D's daughter. Assume further that on D's death, D's revocable trust owns a capital asset with a fair market value of \$1,000,000 and a basis of \$500,000 that passes to D's son. The \$500,000 gain with respect to each asset is to be reported on D's final income tax return. Assuming a federal income tax of 20%, \$200,000 of income tax is owed, computed as follows: 20% capital gains rate x (\$500,000 of gain on probate asset plus \$500,000 of gain on revocable trust asset). Typically, the decedent's estate is burdened with the payment of the decedent's income tax, which includes (1) income arising from assets held in D's name and therefore passing on D's death through probate, (2) income on jointly held properties, and (3) income of trusts over which the grantor held a requisite interest or power (i.e., a Grantor Trust). The Deemed Realization Tax, however, may substantially increase the amount of income tax reported on D's final income tax return. In the above example, D's estate plan passes \$1,000,000 worth of assets with equal bases to each of D's daughter and D's son, treating them equally. The Deemed Realization Tax, however, deems that a capital gain will be realized with respect to both assets, resulting in \$200,000 of income tax that typically would be borne solely by the probate estate. A Deemed Realization Tax would reduce the inheritance to D's daughter, even though D's son receives the benefit of an adjusted basis of \$1,000,000 on the asset he inherits.

Congress may wish to consider granting the decedent's personal representative a right to recover a pro rata portion of the new Deemed Realization Tax arising from non-probate assets being subject to that tax. A similar right to recover estate taxes from non-probate

properties is granted to the decedent's executor and other parties in IRC §§2206, 2207, 2207A and 2207B.

7. Reasons to Elect a Deemed Realization of Gain or Loss for Gratuitous Transfers of Property to Certain Trusts

As noted *supra*, transfers to a spouse or charity, or to a trust in which the taxpayer, his or her spouse, or charity has a qualified beneficial interest (*e.g.*, a QTIP trust, a CLAT or CLUT, a GRAT or GRUT, or a QPRT), as discussed in Paragraphs L and M, *supra*, avoid in part or in whole a deemed realization event. Taxpayers and their personal representatives may want to realize the gain on the date of the transfer in certain situations, even though the law would permit deferral. For example, the taxpayer may have loss carryforwards that could be used to offset the gain attributable to the deemed sale. In addition, the income tax liability with respect to such a deemed sale by a taxpayer would be excludable or deductible on the taxpayer's estate tax return, whereas the income tax liability incurred by the trust later on might not be so deductible. In certain situations, it may be preferable to pay the tax on the initial transfer and avoid the tax on the date that the taxpayer, taxpayer's spouse, or charity, no longer has a qualified beneficial interest in the trust. For example, if the taxpayer anticipates that the transferred asset will substantially appreciate in value after the initial transfer, it may be wiser to realize a relatively small gain on transfer rather than a potentially much larger gain in the future. Congress would need to give careful attention to the details of such an election and the impact such an election would have on the future application of the new tax to the trust during the taxpayer's lifetime.

8. Basis of non-U.S. Situs Property Gratuitously Transferred to a U.S. Person by a NRA or Owned by a NRA on Becoming a U.S. Person, and Deemed Realization of Gain When a U.S. Person Ceases to be a U.S. Person

Congress may wish to address how the Deemed Realization Tax should apply to non-U.S. situs property received by a U.S. person as a gift or bequest from a non-resident alien. Should such property have a basis equal to its fair market value on the date of the gift or the decedent's death? Also, should property owned by a non-resident alien on becoming a U.S. person have a basis equal to its fair market value on the date that he or she becomes a U.S. person? This is the rule under Canadian law. Neither the 1969 Proposal nor the 2016 Proposal deals with this issue.

IRC §877A already provides that a "covered expatriate" generally is deemed to have sold his or her property for its fair market value on the day before the expatriation date. Under a Deemed Realization Tax, an individual who is treated as an expatriate probably should be deemed to have sold all of his or her property whether or not he or she is a covered expatriate.

W. ADVANTAGES OF THE DEEMED REALIZATION TAX

1. Fairness, Consistency, and Equity Would Be Promoted

According to both the 1969 and 2016 Proposals as noted *supra* in Paragraph F, a Deemed Realization Tax would promote fairness and consistency in the income tax law. Under current income tax law, gain generally is not taxed until a realization event occurs, which typically happens on a sale or exchange of the property. A taxpayer can avoid paying income tax on any imbedded gain by either gifting the property during lifetime, resulting in a carryover of the basis to the donee, or holding onto the property until death, at which time the property receives a tax-free adjustment to its basis. As noted in both Proposals, taxpayers who have sufficient cash or a sufficient income stream to maintain their standard of living can avoid income tax by not selling their appreciated property, but less affluent taxpayers often must sell

their property and pay tax on the imbedded gain. Current tax law permits the more affluent to shift the tax that otherwise would be imposed if they sold their property by gifting appreciated property to their donees, and by totally avoiding the tax if they die owning the property, due to the tax-free adjustment in the basis of the property to its fair market value at the time of their deaths. Arguably, the Deemed Realization Tax Proposal would level the playing field by causing a realization of the embedded gain if the taxpayer gifts the property during his or her lifetime and on all assets included in his or her gross estate for estate tax purposes. Thus, the taxpayer during whose lifetime the gain accrues must eventually pay a tax on the unrealized gain on a gift of the property or at death as to the taxpayer's property owned at that time. Simply stated, a Deemed Realization Tax would impose an income tax on the taxpayer who accrues the gain, directly or indirectly, which arguably would treat all taxpayers equitably.

2. Substantial Revenue Would Be Raised Without Increasing Income Tax Rates or Reducing Other Exemptions, Deductions, or Credits

According to the 1969 Proposal and the 2016 Proposal Joint Committee Report as noted *supra* in Paragraph F, a Deemed Realization Tax would raise substantial revenue, and according to the 2016 Proposal Joint Committee Report would do so without increasing income tax rates or reducing other exclusions, deductions, or credits.

3. “Lock-in” Incentive to Retain Substantially Appreciated Property until Death Would be Eliminated

As noted *supra* in Paragraph F, a Deemed Realization Tax would eliminate the “lock-in” incentive to retain substantially appreciated property until death in order to obtain a tax-free step-up in basis where the owner wants or needs to sell such property during his or her lifetime in order to (a) better diversify his or her investments, (b) down-size into a less valuable principal residence or move into an assisted-living or skilled-nursing facility, or (c) raise money for other purposes.

4. The Current Different Treatment for Gifts versus Bequests Would Be Eliminated

Under current law, donees of gifts receive the donor's income tax basis while beneficiaries of property received after death receive an adjusted basis. A Deemed Realization Tax would eliminate the different tax treatment. Instead, donees and beneficiaries would receive an adjusted basis. Gifts would become more appealing under a Deemed Realization Tax because under current law there is a tax disincentive to making gifts of appreciated property.

5. The Current Dilemma between Bequests to a Surviving Spouse versus a Bypass Trust Would Be Eliminated

Under current law, all of the taxpayer's assets receive an adjustment to basis on the taxpayer's death without the imposition of estate taxes for most taxpayers. Assets transferred outright to a surviving spouse or into a Marital Trust and retained by the spouse until death receive another adjustment to basis on the surviving spouse's death. Due to the current taxing threshold for estate taxes, another basis adjustment occurs without the imposition of a transfer tax for most taxpayers. Therefore, taxpayers have an incentive to transfer assets outright to a surviving spouse or into a Marital Trust so that the assets can receive another adjustment to basis on the surviving spouse's death. However, this exposes the assets to an estate tax on the surviving spouse's death, should his or her estate exceed the then threshold amount, which may be more or less than the amount in effect at the time of the taxpayer's death.

Thus, a taxpayer whose primary goal is to provide for the taxpayer's spouse is left with two difficult choices: (1) devise the estate outright or into a Marital Trust where an adjustment to income tax basis will occur on the surviving spouse's death and take the risk that the assets will be subject to estate tax on the surviving spouse's death, or (2) devise the assets into a trust for the surviving spouse that does not qualify for the marital deduction (or that does qualify, but for which the taxpayer's personal representative does not make the QTIP election),

thereby eliminating the exposure to estate taxes on the surviving spouse's death but losing the benefit of the adjustment to income tax basis at that time. A Deemed Realization Tax neutralizes this difficult choice.

A Deemed Realization Tax would deny an adjustment to basis without imposition of income tax. Under a Deemed Realization Tax, on the taxpayer's death, assets that pass to a surviving spouse or into a Marital Trust would not receive an adjustment to basis. If the spouse or trust retains the assets until the spouse's death, the assets would then be subject to a Deemed Realization Tax and correspondingly receive an adjustment to basis. Assets passing outright to the taxpayer's children or into a non-qualifying marital trust (or a qualifying Marital Trust for which the QTIP election is not made) face a Deemed Realization Tax at the taxpayer's death but would receive an adjustment to basis at that time. The assets in a non-qualifying marital trust would not face a deemed realization on the surviving spouse's death and would not receive an adjustment to basis at that time either. No one receives a tax-free adjustment to basis, and no one incurs a tax without a corresponding adjustment to basis. A Deemed Realization Tax neutralizes the estate planning process.

6. The Incentive to Over-value Property at Death to Get a Higher Basis Would Be Eliminated

Generally, the Deemed Realization Tax would eliminate the incentive under current law to over-value property included in a taxpayer's gross estate in order to receive a higher income tax basis when there is no corresponding tax cost (i.e., when the value of the taxable estate falls below the estate tax threshold. If the Deemed Realization Tax were enacted, taxpayers generally would be inclined to seek lower appraised values rather than higher values. Bear in mind that the Deemed Realization Tax would not apply to spousal and charitable transfers, so appraisals would not be needed at the time of the gift or taxpayer's death for the

assets passing to a spouse or charity. Property gifted to other donees or passing at the taxpayer's death to beneficiaries other than a spouse or charity would face a deemed realization of gain or loss at the time of the gift or death, respectively. Few taxpayers would want to pay a higher Deemed Realization Tax to obtain a higher basis for the transferred asset.

X. DISADVANTAGES OF THE PROPOSAL

1. Increased Income Tax Liability Would Arise for Many Decedents' Estates

As set forth *supra* in Paragraph H, the Deemed Realization Tax would likely result in millions of estates being required to pay additional income tax unless the general exemption is substantially greater than the \$60,000 or \$100,000 provided in the 1969 and 2016 Proposals, respectively.

2. Better Record-keeping Would be Required to Determine the Basis of Assets of Decedents

Under current law, assets held at the taxpayer's death generally receive a tax-free adjustment to basis, in which case the taxpayer's basis becomes irrelevant. Under a Deemed Realization Tax, the taxpayer's basis for an asset becomes crucial to the proper determination of the amount of tax. Even if the asset is exempt from the new tax or passes in a manner so that the marital or charitable exclusion would apply, the recipient would need to know the taxpayer's basis because that basis would carry over to the recipient. If a Deemed Realization Tax were enacted, taxpayers would need to retain income tax basis information. Of course, taxpayers should be gathering and retaining this information under current law, because the basis must be ascertained if the asset is sold during the taxpayer's life. However, elderly clients who intend to retain assets until death may decide to destroy basis information, or information of this nature may be unintentionally destroyed if the taxpayer has a long period of disability. In the case of a Deemed Realization Tax imposed at death, the person with the best information regarding basis

is, of course, unavailable, and it may be difficult for the personal representative to obtain accurate basis information for assets the decedent held for a long time.

3. More Complexity Would be added to the IRC

A Deemed Realization Tax would add more complexity to the Code. It could be burdensome to some taxpayers to determine the fair market value of property in order to calculate the amount of taxable gain under current law (although that determination is necessary for reporting taxable gifts and estates). Many more taxpayers would be required to obtain costly appraisals than now need to do so for gift or estate tax purposes.

4. Disputes Relating to Qualification for Special Treatment of Small Family-Owned and Operated Businesses Would Occur

The deferral rules to address liquidity issues could lead to disputes with the IRS as to qualification for the deferral and disputes as to when an entity ceased to be a family-owned and family-operated business.

5. The Proposal Runs Counter to non-Recognition Tax Principle

Taxing unrealized gains violates the current tax principle that capital gains generally are not taxed unless there is an actual sale or exchange. Under current law, income tax does not arise until the property is sold or exchanged in a manner in which deferral is not permitted.³³ Under current law, this tax principle trumps the principle of taxing gain to the taxpayer who experienced the appreciation. A Deemed Realization Tax would impose an income tax even though the asset has not actually been sold or exchanged. Imposing a tax without an actual sale or exchange would invariably force some, and possibly many, recipients to sell the asset to raise cash to pay the income tax. The tax would require some recipients to sell assets when they otherwise might wish to retain them. Generally, economists recommend that

³³ See *supra* footnote 2 for exceptions to this principle.

tax policies be tax neutral. A Deemed Realization Tax would not be tax neutral because some taxpayers would be forced to sell assets to raise cash to pay the income taxes due on a deemed (but not actual) sale.

6. A Deemed Realization Tax Would Lead to Additional Tax Disputes

A sizeable portion of the current estate tax litigation between the Treasury and the taxpayer concerns valuation disputes. The Proposal would increase the number of tax disputes because it imposes the tax on many additional taxpayers. Invariably, the Proposal will significantly increase the number of tax disputes and greatly increase the burden of our courts.

7. Additional Rules and Regulations Would Be Needed

Enacting a Deemed Realization Tax would result in further complexity due to the numerous administrative rules and regulations that would need to be drafted in order to implement the new tax.

Y. PLANNING WITH A DEEMED REALIZATION TAX

In crafting a Deemed Realization Tax, Congress should contemplate what methods taxpayers will use to eliminate or reduce exposure to the new tax after its enactment. After consultation with their advisors, taxpayers will likely implement the same strategies that are currently being used to eliminate or reduce exposure to the current gift, estate and GST taxes. Some of the planning techniques currently being used are (1) removing assets from exposure to estate taxes by tax-efficient gifting, (2) using Grantor Trusts, and (3) using valuation techniques that reduce the transfer tax value of assets.

1. Removing Assets from Exposure to the Deemed Realization Tax

To avoid imposition of estate taxes, taxpayers now make tax-efficient gifts that remove certain assets from the taxpayer's federal gross estate. If a Deemed Realization Tax is enacted, some taxpayers will transfer assets during life so that the assets are not owned at death.

The easiest way for a taxpayer to avoid ownership of an asset at death is to gift the asset to a revocable trust. The transfer is not subject to gift tax because the transfer to a revocable trust is not a completed gift. If the Deemed Realization Tax does not apply to assets in a revocable trust on the taxpayer's death, the tax will be easily avoidable. Contemplating that taxpayers will attempt to avoid the Deemed Realization Tax by this simple transfer, this Report *supra* at Paragraph Q(2)(a) suggests that the Deemed Realization Tax should be imposed on assets held in a revocable trust on the taxpayer's death.

To avoid owning a capital asset with unrealized gains at death, taxpayers will consider gifting the asset. Under both the 1969 and 2016 Proposals, the Deemed Realization Tax is imposed on all gratuitous transfers. Thus, a gift removes the asset from being subject to the Deemed Realization Tax at the taxpayer's death, but triggers imposition of that tax during the taxpayer's lifetime. The benefit of making a gift that triggers the Deemed Realization Tax is to protect future appreciation from being subject to that tax on the taxpayer's death. Taxpayers are using the same technique today to protect future appreciation from estate taxes. However, gifting under the transfer tax regime is much less costly because gifts are not subject to gift tax until the aggregate amount gifted exceeds the taxpayer's applicable exclusion amount. Gifting will be costlier under the Deemed Realization Tax if the basic exemption for the Deemed Realization Tax is set at only \$100,000, as provided in the 2016 Proposal.

Because gifting will come with the high price of a deemed realization, some taxpayers may attempt to reduce the value of the gift by transferring assets to an irrevocable trust and retaining a deductible interest. For valuation purposes, the retained interest will reduce the value of the gift. Taxpayers are using this same technique today to minimize exposure to gratuitous transfer taxes. Because of perceived abuses, Congress enacted IRC §2702 to provide valuation rules with respect to the valuation of retained interests. Because taxpayers will employ

the same techniques in response to the Deemed Realization Tax, Congress may wish to apply similar valuation rules for that tax. *See supra* Paragraph Q(1)(b) wherein this suggestion is made. Because most taxpayers are not subject to transfer taxes (because of the current applicable exclusion amount and the current amount of the GST exemption), Congress cannot assume IRC §2702 will discourage taxpayers from using a GRIT with family members as beneficiaries in their effort to reduce exposure to the Deemed Realization Tax. Consequently, the Deemed Realization Tax should contain a comparable valuation rule.

Of course, many taxpayers will make lifetime gifts outright to their spouses or into marital trusts to postpone the deemed realization of gain. To ensure that the deemed realization is not avoided altogether, a deemed realization must occur on the death of the surviving spouse. The tax will be imposed on assets held by the surviving spouse at death (other than those assets passing to a subsequent spouse or to charity). In addition, the Deemed Realization Tax should apply to capital assets held in Marital GPOA Trusts, Marital Estate Trusts, and QTIP Trusts, as discussed in Paragraph L, *supra*.

Taxpayers will also use charitable split-interest trusts to minimize exposure to the Deemed Realization Tax, as they do now to minimize exposure to transfer taxes. As noted *supra* in Paragraph M, taxpayers can avoid the Deemed Realization Tax by using a CRAT or CRUT if the taxpayer is the only non-charitable beneficiary. To avoid manipulation, Congress should provide that the charitable exclusion from the Deemed Realization Tax is available only for outright gifts to charity and for transfers to CLATs, CLUTs, CRATs and CRUTs. In addition, Congress may want to provide that an income interest in a CRT will be valued at zero. *See supra* Paragraph M for a discussion of this suggestion.

2. Grantor Trust Rules

As discussed exhaustively in Paragraph Q(3), *supra*, Congress will need to address methods to curb abusive uses of the grantor trust rules to ensure that the Deemed Realization Tax is not thwarted.

3. Valuation Techniques

To reduce the value of assets subject to the Deemed Realization Tax, many taxpayers are likely to utilize the same valuation techniques they currently use to reduce exposure to transfer taxes. As noted *supra* in Paragraph V, Congress may want to impose the valuation provisions of Chapter 14 to the Deemed Realization Tax. If Congress extends Chapter 14 to the Deemed Realization Tax, valuation planning will remain as it has in the transfer tax arena. Focus will lie on the creation of family limited partnerships and similar entities.

4. Summary

Planning to minimize exposure to the Deemed Realization Tax will, to a great degree, reflect current planning to minimize exposure to transfer taxes. Taxpayers and their advisors will attempt to shift assets from the taxpayer, use Grantor Trusts, and implement valuation techniques. If a Deemed Realization Tax is enacted, planning methods will continue in current fashion. The repeal of the gratuitous transfer tax law, coupled with the enactment of a Deemed Realization Tax law, would not substantially impact the techniques employed in tax planning, but it will cause more taxpayers to engage in tax planning because most taxpayers are not subject to transfer taxes and because a Deemed Realization Tax is a separate tax and works independently of gratuitous transfer taxes.

Z. LIST OF EXHIBITS

- EXHIBIT A - 1969 Joint Publication of the House Ways and Means and Senate Finance Committees' Tax Reform Studies and Proposals of the U.S. Treasury Department
- EXHIBIT B - Treasury Department's General Explanation of the Administration's Fiscal Year 2016 Revenue Proposals
- EXHIBIT C - Joint Committee on Taxation's Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2016 Budget Proposal
- EXHIBIT D - Comparison of the 1969 Tax Reform Study with the 2016 Deemed Realization Proposal
- EXHIBIT E - Application of the Deemed Realization Tax When Part, But Not All, of an Estate or Trust Passes to a Surviving Spouse or when Community Property is Held in a Joint Administrative Trust and the Trust Estate Can Be Distributed Non-Pro Rata by the Trustee

EXHIBIT A

91st Congress }
1st Session }

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FEBRUARY 5, 1969

PART 3

NOTE: This document has not been considered by either the Committee on Ways and Means of the House of Representatives or the Committee on Finance of the Senate. As indicated in the letters of Chairman Mills and Chairman Long, the document is being printed for information purposes only so as to make it generally available.

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VIII-A. TAXATION OF APPRECIATION OF ASSETS TRANSFERRED AT DEATH OR BY GIFT

GENERAL EXPLANATION

GENERAL EXPLANATION AND DESCRIPTION

Under present law, a person whose income consists of salaries, wages, dividends, or business profits is taxed at ordinary income rates on an annual basis. Special treatment is afforded to income from the sale of capital assets in that such income is taxed at a lower rate when the assets are sold. In both these situations, the estate which the taxpayer passes on to his wife and children at his death is accumulated after income taxes have been paid.

However, a person who holds capital assets which have appreciated in value until death can avoid taxation of this income altogether. Moreover, the recipient of the property takes as his cost or basis the fair market value at date of death, so that the capital gain income represented by the appreciation in value is never taxed under the income tax. This means that a person who can afford to accumulate income in the form of unrealized capital gains can then pass on that accumulated wealth free of income tax—in contrast to the wage earner, salaried individual, or taxpayer who has sold capital assets, all of whom transfer their accumulated wealth after it is reduced by income taxes.

As a result of this situation :

There is inequality in the income tax treatment of people who accumulate their estates out of currently taxable income as compared to those who accumulate estates by means of unrealized capital gains.

At least \$15 billion a year of capital gains fall completely outside the income tax system.

There are undesirable economic effects because of the resulting "lock-in" effect.

These problems—taxpayer inequity, revenue loss, and lock-in effect—must be analyzed in some detail to appreciate their significance.

TAXPAYER INEQUITY

A great deal of income after tax from wages, dividends, and the like is saved; that is, it serves to increase the wealth of the taxpayer. Another taxpayer may find that his wealth has increased because the assets he owns have increased in value.

A simple example will clarify the point that these two paths to wealth accumulation are at present given dissimilar tax treatment.

Assume Taxpayer A earns \$200,000 and pays tax of 50 percent or \$100,000. For simplicity, it is assumed that he intends to save half of his income and to consume half. This means that he will have \$50,000 for consumption and \$50,000 that he can invest in, say, common stock.

Taxpayer B earns \$100,000 on which we will say he pays 50 percent in tax and he uses this entirely for consumption. Taxpayer B, however, differs from A in that when the year started he already owned common stock worth \$200,000; and during this period it rose in value by 50 percent or by \$100,000.

Clearly Taxpayer A tried to increase his wealth by \$100,000. He wanted to save half of his income, but the tax cut it down. He only increased his wealth \$50,000 after tax. B finds that his wealth has increased; and since our present tax law does not count unrealized appreciation in value as taxable income, he is able to add the whole increase in value to his wealth.

The fact is that the two taxpayers have paid quite different rates. A has paid \$100,000 of tax, and B has paid only \$50,000. But it cannot be said that A really has more ability to pay than B. They both paid the same tax on the \$100,000 of the before-tax income that they used for consumption. They both spend the same on consumption, so it could even be assumed that they lived in the same kind of houses, ate the same food, and took the same vacations. The extra ability to pay that A has is really the extra income that he used to increase the value of his holdings in securities. But B increased the value of his holding in securities by twice as much as A did.

For administrative reasons the tax system does not every year make B calculate how much his holdings have appreciated in value. The law permits B to postpone including this appreciation until he sells his assets. But more often than not appreciation is not sold; it is used for estate building and at the time of death the gain is not subject to income tax. The heir treats as his "cost" the value of the property at the time of death.

The estate tax will fall on both A and B so it is not relevant to say that B ought not to pay any income tax on his accumulation of wealth "because he pays an estate tax." A has paid income tax on the money that he earned to build an estate *and* an estate tax. B avoided income tax on his wealth increase and *only* an estate tax was paid on it.

The substance of the present proposal is to reduce the estate tax rate by about the amount raised by capital gains tax at death. Thus the combined tax will be reduced on A and increased on B. The increase on B will be equivalent to what would have happened if B had sold his appreciated property just before death. B would then pay the capital gains tax, but the amount of the capital gains tax would be out of the estate making the estate tax somewhat lower. The proposal would tax the capital gain at death and then allow the capital gains tax as a deduction from the estate.

B. will still be taxed more favorably if he holds his appreciation until death than if he sold it during lifetime. This occurs because the postponement means that during his life B will have had more money invested and thus more income (or appreciation) than he would if he had sold before death. B is also benefited since a gain at death does not come into the proposed minimum tax base. B has an even greater advantage compared to an individual who accumulates his wealth out of ordinary income like salary or dividends. Not only does B get to postpone the tax on his wealth increase but he also pays tax on it at capital gains rates, not ordinary income rates.

Finally the transition proposal allows B to avoid tax on all appreciation up to the date of enactment.

To explain fully the case for this proposal, it is useful to address three issues that are often raised.

(1) *Question.* Is it sound to call the increase in value of B's property income at his death when the property has not yet been sold and may go down in value?

Answer. Assets that have not appreciated are valued under present rules for estate tax purposes and that value is the basis for an estate tax that goes up to 77 percent. These assets also might go down in value, and both kinds of assets might go up even more. These subsequent value changes can properly be treated as gains or losses to the heir.

(2) *Question.* Is it fair to tax B on an appreciation of value which just matches the general rise in consumer prices?

Answer. One answer is that A is taxed on the same thing. The entire tax system is based on money income. Inflation gains are not excluded, nor are deductions allowed for inflation losses. An obvious reason for taxing inflation gains is that to the extent of inflation gains an individual benefits by escaping from the reduction of purchasing power that inflation imposes on holders of fixed dollar claims. The burden can be shared more equally if some tax is imposed on the benefit from escaping inflation.

Further, over the long run the principal assets involved in appreciation, land and stocks, have increased in price over twice as fast as consumer prices. This is important when one recognizes that the capital gains rate is a maximum 25 percent.

(3) *Question.* Won't a tax on the appreciation transferred at death hurt families that have wealth in illiquid form?

Answer. To some extent the appreciation can be in relatively illiquid form, but the far greater portion of it will be in highly liquid common stocks. If there is reason to regard illiquidity as a problem, it makes far more sense to provide some appropriate means of paying death taxes in the illiquid cases than to favor a large group of estates with appreciation in liquid form. The present proposals deal with the illiquidity problem directly, both as to the proposed capital gains tax at death and the estate tax itself.

REVENUE LOSS

On estate tax returns filed in 1966, the total value of property of a type that might show appreciation (stock, real estate, trust interests and noncorporate business assets) was about \$15 billion. The portion of this that represented appreciation was probably in the range of 40 to 50 percent.¹

¹ B. Okun ("The Taxation of Decedents' Unrealized Capital Gains," *National Tax Journal*, December 1967, pp. 368-385.) Estimates the ratio of appreciation to value as 45 percent for real estate and 54 percent for stock. Brannon, McClung and Copeland ("Unrealized Appreciation Passing at Death," *American Statistical Association Proceedings*, 1967, pp. 147-167) derive minimum estimates of 37 percent for stock and 33 percent for real estate. These are minimum in the sense that they are derived from an assumption that assets sold by a taxpayer are randomly drawn from his holdings. A rational investment strategy would be to prefer to sell the assets with less appreciation and thus less current tax. This would imply a higher ratio of appreciation for assets left in the portfolio. Barlow, Brazer and Morgan (*The Economic Behavior of the Affluent*, Brookings, 1966) report the result of their interview survey that among the very high-income group capital appreciation was the source of 51 percent of their wealth.

This suggests that the appreciation passing through the estates of estate tax filers in 1966 must have been in the general magnitude of \$6 to \$8 billion, or about \$7 billion. An additional amount of appreciation about 65 percent as large, or about \$4.5 billion, passed from decedents for whom an estate tax return was not required.²

Table 1 following indicates some aspects of taxing appreciation at death by income level. The data indicate the situation 10 years after the new basis date (date of enactment), when it is assumed that the average property of a type subject to appreciation (principally stock, real estate, trust interests and noncorporate business assets) will reflect an average appreciation of about 25 percent.

TABLE 1.—DATA ON THE OPERATION OF THE PROPOSAL FOR TAXING GAINS AT DEATH 1981¹

Economic estate class (in thousands of dollars)	Percent of estate of appreciable assets ²	Percent of appreciation ³	Appreciation as percent of economic estate	Net capital gains tax as percent of economic estate ⁴	Net capital gains tax as percent of present law estate tax after credits
60 to 100.....	62	20	12.3	0.7	84.0
100 to 200.....	67	22	14.5	1.4	30.0
200 to 400.....	75	23	17.4	1.6	15.2
400 to 600.....	78	25	19.7	1.9	12.9
600 to 1,000.....	80	27	21.4	2.2	13.3
1,000 to 2,000.....	83	30	24.5	2.6	13.5
2,000 to 3,000.....	82	32	26.2	2.7	12.4
3,000 to 5,000.....	83	35	29.1	2.9	12.0
5,000 and up.....	86	37	32.2	2.8	11.7

¹ An effective date of Jan. 1, 1970, is assumed.

² Includes stock, real estate, trust interests, and noncorporate business assets. The economic estate is gross estate less debts.

³ This takes into account the observed patterns that appreciation rates and holding period are higher at the upper wealth levels plus some shifting asset composition. (E.g., the personal residence with a low appreciation rate is more important at low wealth levels.)

⁴ This takes into account 4 factors: (a) the tendency for applicable capital gain rates to be higher at upper wealth levels, (b) the deduction for contributions which is higher at upper wealth levels, (c) the deduction of marital bequests which is greater at lower wealth levels, and (d) the deduction of the capital gains tax against the estate tax (at 1980 rates) which is more valuable at higher wealth levels.

UNDESIRABLE ECONOMIC EFFECTS

When tax liability is allowed to depend on whether an appreciated asset is sold or kept until death, the tax law operates to produce undesirable economic effects, particularly in cases of older people. Assets become immobilized; investors become "locked-in" by the prospect of avoiding income tax completely if they hold appreciated assets until death rather than selling them. This freezing of investment positions deprives the economy of the fruits of an unencumbered flow of capital toward areas of enterprise promising larger rewards.

PROPOSAL

To remedy these problems, under the proposal persons holding appreciated capital assets at death would be treated as if they had sold such assets just before death, and such gains would be taxed in the final income tax return of the decedent. The tax rate would be that now applicable to capital gains on assets sold during life. The tax on these gains at death would be due under the income tax, but the amount

² Okun, *op. cit.*, p. 385.

of the tax would be deducted in determining the amount of property subject to estate tax. The taxable estate would thus be net of the income tax paid, as is the case for those who accumulate their estates out of ordinary income or out of capital assets sold prior to death. The assets taxed at death would take as their cost or basis the fair market value at death, as is true today.

The transition to the new system will be smoothed for those who are now holding appreciated assets in anticipation of tax-free transfers at death, by a provision that only appreciation occurring after the date of enactment would be subject to tax at death.

The following measures insure the equitable operation of the new law:

Only appreciation occurring after the date of enactment would be subject to tax;

Taxpayers would be allowed a minimum basis of \$60,000, with the result that no tax at all would be imposed on the appreciation when the total value of assets transferred is \$60,000 or less;

Complete exemption would be allowed for gain on property transferred to a spouse or to charity;

Limited exemption would be allowed for gain on transfers of property to orphans and transfers of ordinary personal and household effects;

Present rules for payment of taxes due at death for those estates that have liquidity problems will be liberalized, and the new rules will apply to capital gains taxes as well as transfer taxes.

The tax on appreciation on transferred assets would be allowed as a deduction for estate tax purposes;

Net unrealized losses on business or investment property would be allowed as an offset against capital gain and, subject to appropriate limitations, against ordinary income for the 3 taxable years preceding the decedent's final income tax return;

Gains on assets giving rise to ordinary income transferred at death would be eligible for averaging.

OPERATION OF PROPOSAL

Under present law, property that has appreciated in value can be transferred at death without any income tax being imposed on the increase in value that accrued during the decedent's lifetime. At the same time these assets receive a new basis equal to their fair market value at the death of the decedent, so that the predeath appreciation escapes income taxation forever.

Under the proposal the appreciation in assets held at death will be subject to income taxation at that time. The tax will be reported in the decedent's final income tax return (prepared by the executor) and will be due at the same time as the estate tax return of the decedent, that is, 15 months after the date of death.

As under the present estate tax, the fair market value³ of the decedent's property for income tax purposes would be determined as of the date of death or the alternate valuation date (generally 1 year

³ The "fair market value" is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having knowledge of all relevant facts.

after the date of death except with respect to property disposed of during the year following death). The 50-percent exclusion and the alternative 25-percent maximum rate applicable to long-term capital gain will be available regardless of the length of time the decedent has actually held the property. The transferee of the decedent's property would take as his basis the fair market value of the property on the date of death of the decedent, as under present rules.

LOSSES

Where an individual holds capital assets whose fair market value is less than their adjusted tax bases (ordinarily, cost) at the date of his death, the resulting losses will be allowed for tax purposes in the year of death. These losses, as well as losses sustained on sales during the last year of the decedent's life, and any capital loss carryforward from prior years, will be deductible as under the regular rules applicable to capital losses, by first offsetting capital gains of the last taxable year, with any excess allowed, to the extent of \$1,000, as a deduction against ordinary income of that year. If there are still additional unused capital losses remaining, a special rule will permit an offset against capital gains of the decedent in his 3 prior taxable years. If there still remain unused capital losses, an offset against ordinary income in the last taxable year of a decedent will be permitted and then in his 3 prior taxable years.

This special offset of additional amounts of losses against ordinary income will, however, be limited so that capital losses will be deductible only to the same extent that capital gains are included in ordinary income. Thus, generally, 50 percent of capital losses will be deductible, but in no event will the tax benefit resulting from the offset against ordinary income be greater than the tax benefit that would have resulted had the income to be offset been capital gain rather than ordinary income. In other words, the tax saving resulting from the offset of a loss will not be permitted to exceed 25 percent of the amount of the ordinary income offset by the offset. The basis of the loss property in the hands of the decedent's transferee would be fair market value at death as under present law.

RELATION OF INCOME TAX TO ESTATE TAX

The income tax on the gain at death will constitute a debt of the estate and will be deductible for transfer tax purposes, so as to reduce transfer tax liability. The treatment here follows present estate tax rules dealing with debts of an estate and, coupled with the reduction in rates under the unified transfer tax proposal, means that on the average the total taxes paid on death under these proposals will be substantially the same as is paid for estate taxes under present law.

EXCEPTIONS

(A) *Basic exemption*

For purposes of computing gain, every taxpayer would be deemed to have a minimum basis in property owned at death of \$60,000 or fair market value, whichever is lower. If the actual basis exceeds \$60,000,

then gain (or loss) is computed from actual basis. Thus, if a taxpayer has property the total basis of which was \$80,000, gain would be computed from this figure; but if a taxpayer's property had a total basis of \$20,000 and a fair market value of \$35,000 at date of death, no gain would be taxed. In each case, a stepped-up basis equal to the fair market value will be acquired by the transferee.

In addition to the basic exemption, the following exemptions will also be available:

(B) Personal and household effects exemption

The proposal will permanently exempt all gain on ordinary personal and household items of the decedent of a value of less than \$1,000 each. This includes the clothing of the decedent, furniture, appliances, cars, jewelry, furs, works of art, and so forth. Assets of this type that have a value in excess of \$1,000 will not be exempt and will be treated like any other assets of the decedent.

Losses due to depreciation in value of personal and household items will be disallowed following the usual rules relating to losses of a personal nature.

The basis to the decedent's transferee of the personal and household effects passing under the exception will be their fair market value at the decedent's death.

(C) Marital exclusion

As part of the unified transfer tax proposal, a 100-percent marital deduction will apply to transfers between spouses by gift or at death. The marital exclusion under the gain proposal will correspond to the unified transfer tax provisions. No gain will be recognized on the appreciation in value of property passing to the surviving spouse at death which qualifies for the transfer tax marital exclusion.⁴ Where the transferee spouse receives all the property of the decedent, the property will not receive a new basis but will carry over the basis of the decedent. Where the transferee spouse receives less than all the property of the decedent, the basis in such property will be allocated under the rules outlined in (F) below.

(D) Orphan exclusion

Gain on property passing to orphans, which is excluded from the transfer tax under the unified transfer tax proposal, will also be excluded from the gain proposal. The property will have a basis in the hands of the transferees computed under the rules set forth in (F) below, and gain will be subject to taxation upon disposition by them.

(E) Charitable bequests exemption

Gain on assets transferred to charity will be permanently exempt from tax if the amount of the interest given to charity can be measured with certainty. Thus, no tax would be imposed on the appreciation in property given outright to a qualified charity. Where a transfer creates split interests (e.g., a trust to pay the income to the transferor's son for life, with the remainder to the ϕ charity or vice versa), the same rules will apply as apply to gifts or bequests to charity.

⁴ This provision, the orphan exclusion, and the basic \$60,000 exemption make it unnecessary to establish a separate rule for personal residences. Gain on intrafamily transfers will generally be exempted under these provisions. There is no reason to exempt gain on transfers of residences to persons other than spouses or orphans.

(F) Allocation of basis

The exemption of gain on property passing at death to a surviving spouse, to orphans, or to charity requires a special rule relating to basis, so that, in the case of the spouse or orphans, the gain that escapes tax at the death of the decedent will be taxed when the property is later transferred by such spouse or orphan. The basic objective of using allocated, rather than actual, basis is to eliminate any tax incentive for the decedent or his executor to transfer any particular piece of property to any particular person or entity, where such a disposition might be undesirable from a nontax standpoint. For example, if an estate consists of low-basis stock in a family corporation that the decedent would, in the absence of tax considerations, want to go to his son, and of high-basis property of equal value that he would want to go to his wife, it seems improper to create a significant tax incentive for achieving precisely the opposite disposition. A rule that taxed or exempted gain on the basis of the particular property going to each would have such an effect, since under such a rule the gain on the shares of stock in the family business could escape taxation at the decedent's death only if that property were left to the wife. To avoid this effect the proposed basis rule would require allocation of total basis among all property (other than cash) before computing the taxable gain, with a carryover of such allocated basis in the case of property on which gain is exempt. (This rule need not, and will not, apply where all the decedent's property passes to one person.) The same considerations that require allocation in the case of an estate passing in part to a spouse also require allocation in the case of property passing in part to orphans or charities.

ITEMS GIVING RISE TO ORDINARY INCOME

Under present law, special treatment is given to items of income which are earned by a decedent prior to his death, but which are not reportable in the decedent's final income tax return. Example of this type of income are wage claims of the decedent, receivables, certain deferred compensation payments, and interest on U.S. savings bonds. Such income must be reported by the person to whom the asset is given by the decedent at the time it is received by that person. Although the recipient of the income does not receive any step up in basis on the decedent's death, a deduction is allowed to the recipient for the estate tax attributable to the inclusion of the item in the decedent's estate for Federal estate tax purposes.

Present rules were designed to avoid bunching of ordinary income in the decedent's final return. However, complexities of present law have produced troublesome problems. Therefore, this proposal substitutes a new rule for decedents dying after December 31, 1969.

The new rule would be that gain on an asset, the sale or exchange of which would produce ordinary income or capital gain, or a combination of both, will be taxed at death with ordinary income to the required extent and capital gain as to the remainder. Thus, for example, in the case of a wage claim of a decedent, the entire amount of the wage claim will be includible in the decedent's final return and taxed at ordinary income rates.

To avoid the bunching problems for which the present rules were developed, the usual averaging rules will apply to ordinary income that is taxed at death by virtue of this proposal. In addition, the 100-percent marital exclusion, the orphans exclusion, the deduction for income taxes as a debt of the estate, and the basic \$60,000 exemption⁵ will all be applicable to such items of income, thereby further ameliorating the bunching problem.

Special rules for assets that give rise both to ordinary income and to capital gains will be provided. Deductions attributable to income taxed at death will be allowed, but no double deductions will be permitted as is sometimes the case under present rules.

Recipients of items giving rise to the taxation of ordinary income under this proposal will receive a market value basis as to such items.

TRANSFER OF LIFETIME GIFTS

In order that the proposed imposition of the tax on gain will neither encourage nor discourage lifetime transfers as opposed to death transfers, the gain on appreciated property transferred by gift by a taxpayer will be subject to income taxation at the time of transfer. A gift will not be treated as "completed," that is, subject to tax, unless the transfer is of a type on which the transfer tax is imposed under the unified transfer tax proposal. Generally, the rules applicable to death transfers will apply to lifetime transfers.

The following exceptions, corresponding to the exceptions for death transfers, will be applicable to lifetime gifts:

There will be an exclusion for ordinary personal household effects;

There will be an exclusion for charitable gifts;

There will be a marital exclusion on gifts between husband and wife so as to produce a result comparable to that produced by the marital exclusion on transfers at death.

Losses will be allowed on lifetime gifts under the same rules as apply at death. However, no losses will be allowed on transfers between related parties.

FUTURE INTERESTS

Under the unified transfer tax, a substitute tax, in addition to the basic tax, would be imposed on certain complex arrangements designed to avoid tax by passing property through several generations without subjecting the property to tax in each generation. A similar problem exists in the case of capital gains tax imposed on the appreciation in the value of property transferred at death or by gift. The tax could be avoided by transferring property in such a form that the appreciation would go untaxed through several generations.

To foreclose such a possibility, thereby assuring that all taxpayers will be treated equally, a special rule would tax the appreciation when distribution following an initial transfer is made to persons who are more than one degree lower than the transferor, for example, a grandchild.

⁵ On death, the basic \$60,000 exemption must be allocated first to capital assets. To the extent if it is not used up, the balance can be allocated to ordinary income items. The basic exemption will not be available for lifetime transfers of ordinary income items.

EFFECTIVE DATE

The new rule would apply to transfers by gift or by death after December 31, 1969.

For purposes of computing gain on property acquired before the date of enactment the taxpayer, or his personal representative, will have the option of using as his basis, either—

- (1) Adjusted basis as computed under existing rules; or
- (2) The value on the date of enactment as adjusted under present rules for any changes occurring after that date, including the depreciation or depletion (cost or percentage) actually taken after such date.

For purposes of computing losses on property acquired before the date of enactment, the basis is the lower of (1) or (2) above.

VIII-A. TAXATION OF APPRECIATION OF ASSETS TRANSFERRED AT DEATH OR BY GIFT

TECHNICAL EXPLANATION

1. GENERAL MANNER OF OPERATION OF PROPOSAL

Under present law, property that has appreciated in value can be transferred at death without any income tax being imposed on the increase in value that accrued during the decedent's lifetime. At the same time these assets receive a new basis equal to their fair market value at the death of the decedent, so that the predeath appreciation escapes income taxation forever. Under the proposal the gain on assets held at death, including assets over which the decedent has a general power of appointment will be subject to income taxation at that time. The gain will be reported in the decedent's final income tax return (prepared by the executor) and will be due at the same time as the estate tax return of the decedent, 15 months after the date of death. As under the estate tax, the fair market value of the decedent's property for income tax purposes could be determined as of the date of death or the alternate valuation date (generally 1 year after the date of death except with respect to property disposed of during the year following death). The 50 percent exclusion and the alternative 25 percent maximum rate applicable to long-term capital gain will be available regardless of the length of time the decedent has actually held the property. Various exceptions that reduce the taxable gain will be provided for personal and household effects, property transferred to a surviving spouse, and property transferred to charity. A minimum basis will be proposed in the case of transfers at death. The basis of the property subject to tax will be stepped up to fair market value in the hands of the decedent's transferee as under present law. Only appreciation in value that occurred after the date of enactment will be taxed. The income tax attributable to the gains taxed at death will be deductible from the gross estate of the decedent in determining estate tax liability, thereby reducing Federal estate taxes.

2. LOSSES

Where an individual holds capital assets whose fair market value is less than their adjusted tax basis at the date of his death, the losses will similarly be allowed on the transfer at death. These losses, as well as losses sustained on sales or exchanges during the last year of the decedent's life and any capital loss carryforward from prior years, will be deductible, as under the regular rules applicable to capital losses, by first offsetting capital gains of the last taxable year (including gains exempted under the minimum basis rule in 4(a) below) and then being allowed to the extent of \$1,000 against ordinary income of that year. If then there are additional unused capital losses remaining, a special rule will permit an offset against capital gains of the decedent in his 3 prior taxable years. If then there are still unused capital losses, an offset against ordinary income in the last taxable year of a decedent, and then in his 3 prior taxable years, will be permitted. This special offset of additional amounts of losses against ordinary income will, however, be limited so that capital losses will be deductible only to the same extent that capital gains are included in ordinary income. Thus, generally, 50 percent of capital losses will be deductible, but in no event will the tax benefit resulting from the offset against ordinary income be greater than the tax benefit that would have resulted had the income to be offset been capital gain rather than ordinary income. In other words, the tax saving resulting from the offset of a loss will not be permitted to exceed 25 percent of the amount of ordinary income so offset. The basis of the loss property in the hands of the decedent's transferee would be fair market value at death as under present law.

3. RELATION OF INCOME TAX TO ESTATE TAX

The income tax on the gain at death will constitute a debt of the estate and will be deductible from the gross estate for estate tax purposes, so as to reduce any estate tax liability. The treatment here follows estate tax rules dealing with debts of an estate. Refunds are assets of the estate.

4. EXCEPTIONS

Appropriate exceptions are provided under the proposal so that its application will be equitable and moderate. Exceptions are provided for ordinary personal and household effects, so that any appreciation in such assets will not be taxed and the transferee of the assets will have a basis equal to the fair market value at the decedent's death. In order that small estates will generally be exempt from income tax as well as estate tax, gain will only be taxed at death to the extent the value of the property exceeded the greater of the decedent's aggregate basis or \$60,000. In effect, every decedent will have a minimum basis of \$60,000, so that gain will only be taxed to the extent fair market value exceeds \$60,000, or the decedent's actual basis, whichever figure is the larger. Thus if a decedent owned property at death with a basis of \$40,000 and a fair market value of \$80,000, only \$20,000 in gain would be subject to income tax. A marital exclusion will cover property

transferred to a surviving spouse and will be analogous to the marital deduction for estate tax purposes. The property passing under this exception will retain the basis of the decedent, so that upon disposition of the property by the surviving spouse there will be a recognition of the gain involved. A similar exclusion would cover property passing to orphans. There is also an exception for bequests to charity, the gain involved thus receiving a permanent exemption from income tax. These exceptions are described more fully below.

(a) Basic exemption

Every taxpayer would be deemed to have a minimum basis in property owned at death of \$60,000 or fair market value, if lower. Thus, if a taxpayer had property the total basis of which was \$80,000 and a value of \$100,000, the \$20,000 gain would be taxed; but if a taxpayer's property had a total basis of \$20,000 and a fair market value of \$35,000 at date of death, no gain would be realized. In each case, a stepped-up basis equal to the fair market value will be acquired. If a decedent had property worth \$25,000 but with a basis of \$80,000, the exemption would not come into play, and a loss of \$55,000 would be allowed.

The provisions for the 100-percent marital exclusion, the orphan exclusion, and the basic exemption make it unnecessary to establish separate rules for personal residences. Gain on intrafamily transfers of residences will generally be exempted under these provisions. There seems to be no reason to provide any additional exemption (beyond the basic exemption) for gain on the transfers of residences to persons other than spouses or orphans.

(b) Personal and household effects exemption

The proposal will permanently exempt all gain on ordinary personal and household effects of the decedent of a value of less than \$1,000 per item. This includes the clothing of the decedent, drapery, and carpeting, furniture, appliances, cars, jewelry, furs, works of art, and so forth. Assets of this type that have a value in excess of \$1,000 will not be exempt and will be treated like any other assets of the decedent. For purposes of this rule, assets that constitute a set or collection, such as stamps, guns, coins, or works of art, will be treated as a single asset. When it is determined that a set or collection exceeds \$1,000 in value then each item will be valued individually; gain will be recognized on individual items in the set that have appreciated in value and losses due to depreciation in value will be disallowed under usual rules relating to losses of a personal nature.

Any loss on personal and household effects due to depreciation in value will not be allowable, as under present rules since the loss is of a personal nature.

The basis to the decedent's transferee of the personal and household effects passing under the exception will be their fair market value at the decedent's death.

This exemption provides recognition of the fact that it would be impractical to have the provision apply to a wide range of miscellaneous items of small value. For the most part, of course, the exemption would not be necessary, since these items do not appreciate in value. Nevertheless, generally it will not be necessary to determine whether in fact there has been appreciation in value of these types of

assets. This exemption supplements an annual exception for gifts of ordinary personal and household effects of the type described above.

(c) Marital exclusion.

As a part of the unified transfer tax proposal, a 100-percent marital deduction will apply to transfers between spouses by gift or at death. The marital exclusion under the income tax proposal will correspond to the unified transfer tax provisions so that on transfers that qualify for the transfer tax marital exclusion no gain will be recognized on the appreciation in value of property passing to the surviving spouse at death.⁶ Thus, gain will be exempt on any property (1) that passes outright to a spouse (either during the life of the transferor spouse or at his or her death), or (2) that passes subject to any kind of legal arrangement assuring the transferee spouse for life or for any other period of time the enjoyment or use of such property, or the income from it, or the right, through the exercise of an unrestricted power vested solely in the transferee spouse, to such outright ownership, enjoyment, use, or income, if the transferee spouse consents to having the termination of such limited interests treated as a taxable transfer by him or her. If the transferee spouse does not receive outright ownership, then a taxable transfer occurs upon termination of the transferee spouse's interest.

To protect the transferee spouse from liability from tax on property not fully subject to his or her control or power of disposition, the tax imposed on the gain at termination of one of the kinds of limited interests that is sufficient to qualify property for the marital exemption will be collectible only out of such property.

The rate that will be applied upon the termination of a limited interest in a transferee spouse that qualifies for the marital deduction will be the rate of the legal owner of the property. Thus, in the case of a legal life estate or term for years, gain will be taxed upon the termination of the transferee spouse's interest at his or her rate. On the other hand, in the case of property placed in trust, the rates applicable to the trust will apply. In the case of some form of outright interest passing to a transferee spouse, an option will be made available to have taxed any portion of the property passing under the marital deduction at the time of the transfer. A step up in basis would, of course, accompany this event. The election to be taxed will be exercisable by the transferor and, in the case of a transfer at death, if the transferor makes no election, then by the transferee spouse. Where the transferee spouse receives all the property of the decedent, the property will not receive a new basis but will carry over the basis of the decedent. Where the transferee spouse receives less than all the property of the decedent, the basis in such property will be computed under the rules outlined in (f) below.

(d) Orphan exclusion.

Provision will be made that gain on property passing to orphans, which is excluded from the transfer tax under the unified transfer tax proposal, will also be excluded from tax on the death of the de-

⁶This includes appreciated property transferred pursuant to a separation agreement or divorce decree. Under present rules a capital gains tax is imposed and the transferee spouse receives a stepped-up basis. Under the proposal, the transferee spouse will take a carry-over basis, unless the option to pay the tax is exercised by the transferor-spouse.

cedent. The property will have a basis in the hands of the transferees computed under the rules set forth in (f) below, and gain will be subject to taxation upon disposition by them.

(c) Charitable bequests exemption.

Gain on assets transferred to charity will be permanently exempt from tax if the amount of the interest given to charity can be measured with certainty. Thus, no tax would be imposed on the appreciation in property given outright to a qualified charity. Where a transfer creates split interests (that is, a trust to pay the income to the transferor's son for life, with the remainder to the X charity or vice versa), the portion going to the charity will qualify for the exemption only if—

(1) The income beneficiary receives an outright annuity (stated in terms of a fixed annual dollar amount or a fixed percentage of the fair market value of the property at the time of the transfer); or

(2) The governing instrument provides that the transferred property is to be valued annually, and a fixed percentage of the fair market value of the property on each valuation date is to be distributed to the income beneficiary. The required distribution is to be made first from income and then from corpus. To insure that fair market values will be determined objectively, in the case of lifetime transfers the donor will be subject to a 10-year waiver of the statute of limitations with respect to assessment of a capital gains tax on the transfer. In the case of deathtime transfers, the trustee or other person determining fair market value must be independent of the beneficiaries of the transfer.

Only split-interest transfers satisfying one of the above tests will qualify for the charitable exemption. All other types of split-interest transfers will be subject to capital gains tax even though a charity may be a potential beneficiary. Thus, for example, if there exists any contingency which could result in the defeat of the charitable interest, or a power to divert the property to or for the benefit of someone other than the charity, the above tests are not met and the transfer does not qualify for the exemption. Also, in cases where the charity has only an income interest, if the period of the charity's interest is measured by the life of any person, no charitable exemption is allowed.

The purpose of these rules is to insure that the charity will in fact receive a specified and determinable amount. The rules for treatment of gain on transfers to charity basically follow the proposal setting forth the rules for deductibility of charitable contributions for income tax purposes, and insure that any charitable transfer will be exempt under this proposal if it is also exempt from transfer tax under the unified transfer tax proposal.

Where an asset giving rise to ordinary income is transferred to charity at death, the exemption will not apply and the ordinary income will be taxed in the decedent's final return.

(f) Allocation of basis.

The exemption of gain on property passing to a surviving spouse, to orphans, or to charity requires a special rule relating to basis, so that, in the case of the spouse or orphans, the gain that escapes tax at

the death of the decedent will be taxed when the property is transferred by such spouse or orphan. The basic objective of using allocated, rather than actual, basis is to eliminate any tax incentive for the decedent or his executor to transfer any particular piece of property to any particular person or entity, where such a disposition might be undesirable from a nontax standpoint. For example, if an estate consists of low-basis stock in a family corporation that the decedent would, in the absence of tax considerations, want to go to his son and of high-basis property of equal value that he would want to go to his wife, it seems improper to create a significant tax incentive for achieving precisely the opposite disposition. A rule that taxed or exempted gain on the basis of the particular property going to each would have such an effect, since, under such a rule, the gain on the shares of stock in the family business could escape taxation at death only if that property were left to the wife. To avoid this effect the proposed basis rule will require allocation of total basis among all property (other than cash) before computing the taxable gain, with a carryover of such allocated basis in the case of property on which gain is exempt. (This rule need not, and will not, apply where all the decedent's property passes to one person). The same considerations that require allocation in the case of an estate passing in part to a spouse also require allocation in the case of property passing in part to orphans or charities.

To illustrate the process of allocation of basis, assume that an estate, after all debts, expenses, and taxes have been paid or provided for, consists of \$100,000 in cash, \$450,000 worth of stock of X corporation with a basis of \$50,000, and \$450,000 worth of stock of Y corporation with a basis of \$450,000. Thus the total gain is \$400,000. If half of the estate is left to the wife and half to the son, then regardless of how particular property is disposed of, half the gain will be taxed in the decedent's final return and the wife will receive a basis such that the remaining gain would be taxed to her if she sold the property at a time when it had not changed in value. Specifically, suppose that the X stock goes to the son and the Y stock goes to the wife and each gets half of the cash. Total basis is \$600,000, of which \$100,000 must be assigned to the cash. The remaining \$500,000 is allocated half to the X stock and half to the Y stock. Thus, the \$450,000 worth of X stock which passes to the son has an allocated basis of \$250,000 and a gain of \$200,000. This gain is taxed in the decedent's final return and, as a result, the son's basis will become \$450,000. The \$450,000 worth of Y stock passing to the wife will have an allocated basis of \$250,000, but this gain is exempt from tax and, as a result, the wife's basis for the Y stock will be \$250,000. If the facts are changed so that \$90,000 worth of X stock is left to a charity and the son simply receives that much less X stock, then the results are as follows:

Recipient	Property	Value	Allocated basis
Wife.....	Y stock.....	\$450,000	\$250,000
	Cash.....	50,000	50,000
Son.....	X stock.....	360,000	200,000
	Cash.....	50,000	50,000
Charity.....	X stock.....	90,000	50,000

Only the \$160,000 gain on the X stock passing to the son will be taxed in the decedent's final return. The wife's basis for her Y stock will again be \$250,000. Technically, the basis of the stock passing to the charity will be \$50,000 though ordinarily this will be irrelevant since any gain realized by the charity on disposition will be nontaxable.

Where assets giving rise to ordinary income comprise part of the estate, special adjustments must be made in the allocation of basis rules. Where a beneficiary receives an ordinary income asset, the basis of the ordinary income item is allocated according to the portion actually received by the particular beneficiary. That beneficiary's portion of the allocated basis in the capital assets (computed as above) which he receives is then reduced (dollar-for-dollar) by the amount of the basis attributable to the ordinary income item received by the beneficiary.

The following examples illustrate the application of the allocation of basis rules where ordinary income items are involved: *Example 1:* A husband leaves one-half of his estate to his wife and one-half to his son. The estate consists of inventory worth \$120,000 with a basis of \$20,000; \$450,000 worth of X stock with a basis of \$50,000; and Y stock with a value of \$450,000 and a basis of \$450,000. If one-half of the inventory and the X stock are left to the wife, and one-half of the inventory and the Y stock to the son, then the results are as follows:

Recipient	Property	Value	Allocated basis	Gain
Wife.....	Inventory.....	\$60,000	\$10,000	¹ \$50,000
	X stock.....	450,000	250,000	² 200,000
Son.....	Inventory.....	60,000	10,000	³ 50,000
	Y stock.....	450,000	250,000	³ 200,000

¹ Taxed to wife at ordinary income rates upon receipt or disposition.

² Taxed to wife at capital gain rates on disposition.

³ Taxed in decedent's final return at ordinary income rates and capital gain rates respectively. Son picks up new basis.

Example 2: If all the inventory and \$390,000 worth of X stock were left to wife and the balance to the son, then the results are as follows:

Recipient	Property	Value	Allocated basis	Gain
Wife.....	Inventory.....	\$120,000	\$20,000	¹ \$100,000
	X stock.....	390,000	240,000	² 150,000
Son.....	X stock.....	60,000	10,000	³ 50,000
	Y stock.....	450,000	250,000	³ 200,000

¹ Taxed to wife at ordinary income rates upon receipt or disposition.

² Taxed to wife at capital gain rates upon disposition.

³ Taxed in decedent's final return at capital gain rates. Son picks up new basis.

Example 3: If all the inventory had been left to the son, then the results are as follows:

Recipient	Property	Value	Allocated basis	Gain
Wife.....	X stock.....	\$450,000	\$250,000	¹ \$200,000
	Y stock.....	60,000	10,000	¹ 50,000
Son.....	Inventory.....	120,000	20,000	² 100,000
	Y stock.....	390,000	240,000	² 150,000

¹ Taxed to wife at capital gain rates on disposition.

² Taxed in decedent's final return at ordinary income rates and capital gains rates respectively. Son gets new basis in each item.

5. PROVISIONS DEALING WITH LIQUIDITY

It is recognized that in some circumstances there may be difficulty in having liquid assets available for payment of the tax on gain at death. Several provisions of the tax law presently deal with the problem of liquidity in connection with the payment of estate taxes. Thus, section 303 of present law permits the redemption of stock in closely held corporations in certain cases, without the payment of ordinary income tax on the redemption, in order to provide funds for the payment of estate taxes. Section 6166 of present law permits, under similar circumstances, installment payment of estate taxes for a period of up to 10 years with the application of a 4-percent rate of interest. Section 6161 provides for installment payments for up to 10 years in cases of undue hardship with the application of a 4-percent rate of interest.

The proposals broadening the liquidity provisions governing payment of transfer taxes at death will also cover the income taxes attributable to the gains taxed at death.

6. TREATMENT OF NONCAPITAL AND HYBRID ASSETS

Under present law, section 691 provides, in general, that all items of income which were earned or realized by the decedent prior to his death but which were not reportable in the decedent's final return under general (e.g., cash or accrual method) or special (e.g., statutory installment sales provision) accounting rules must be reported as income by the successor in interest of the decedent at the time of receipt. Such income must be treated in the same manner by the recipient (e.g., as ordinary income or capital gain) as it would have been treated by the decedent had he lived and received the item. Such items are includible in the decedent's gross estate. Although they do not receive a step-up in basis (sec. 1014(c)), the estate tax attributable to such items is allowed as a deduction to the successor in interest of the decedent in computing the income tax on the item (sec. 691(c)).

The rules presently contained in section 691 were developed to avoid the bunching of income in the decedent's final return. But the complexities of section 691 have created troublesome problems. Therefore, for decedents dying after December 31, 1969, section 691 would cease to have application. The basic rule would be that gain on an asset, the sale or exchange of which would produce ordinary income or capital gain, or a combination of both, will be taxed at death with ordinary income to the required extent and capital gain as to the remainder.

The bunching problem for which present rules were designed would be solved by providing that the general averaging rules will apply to ordinary income taxed at death because of this proposal. In addition, the 100-percent marital exclusion, the orphans' exclusion, the deduction of income taxes as a debt of the estate, and the basic exemption⁷ will all apply to gain on items that have heretofore been covered by section 691.

⁷ On death, the basic \$60,000 exemption must be allocated first to capital assets. To the extent it is not then used up, the balance can be allocated to ordinary income items. The basic exemption will not be available for lifetime transfers of ordinary income items.

Examples of assets which would give rise to the taxation of ordinary income on the death of the decedent include wage claims of the decedent, stock in trade and inventory (wholesale value), accounts receivable, interest on the U.S. savings bonds, and stock of foreign investment companies under section 1246.

Installment obligations, options (including stock options), and assets on which gain may produce ordinary income only because of an insufficient holding period will be taxed as long term capital gains in the final return of the decedent. Thus, gain on depreciable real estate and on stock in collapsible corporations would receive capital gain treatment. Dispositions of section 306 stock would give rise to capital gain; however, in the case of lifetime transfers the stock would retain its "taint" in the hands of the donee.

Partnership interests, as under ordinary rules for such interests, will produce capital gain at death, except in special circumstances governed under existing rules in the case of a retiring or deceased partner.

Assets such as depreciable property subject to section 1245, and stock of foreign corporations under section 1248 will produce ordinary income or capital gain as if the property had been sold by the decedent. The transferee of the property will then have a stepped-up basis.

Deductions in respect of a decedent presently provided for in section 691 (b) will be allowable in the final return of the decedent. No double deduction for such items will be allowed and section 642(g) would be changed accordingly.

Recipients of items giving rise to taxation of ordinary income under these rules would receive a stepped-up basis as to such items. Amounts received by the recipient in excess of (or below) basis will result in ordinary income (or loss). Ordinary rules will govern the sale of such assets by a beneficiary.

7. TREATMENT OF LIFETIME GIFTS

In order that the proposed method of taxing gain will operate neutrally (i.e., that imposition of the tax will neither encourage nor discourage lifetime transfers as opposed to death transfers), the gain on appreciated property transferred by gift by a taxpayer will be subject to income taxation at the time of transfer. A gift will not be treated as "completed," and the gain on the property will not be subject to income taxation, unless the transfer is of a type on which the transfer tax is imposed under the unified transfer tax proposal. Generally, the rules applicable to death transfers will apply to lifetime transfers.

With respect to gifts involving present and future interests in property, rules to determine the appropriate amount of gain to be taxed will be applied which are analogous to those presently used to determine the value of the various interests. For example, if a donor gives a life interest in certain property to A with a remainder to X charity, and the life interest is determined to be equal to 40 percent of the value of the property and the remainder 60 percent, then 40 percent of the gain from the appreciation in the property would be subject to income tax and 60 percent would be exempt under the charitable exception. (The same procedure will be followed with

respect to bequests of present and future interests in property transferred at death.)

However, the donor will realize ordinary income where he makes a lifetime transfer of depreciable property to or for the benefit of his minor issue, or their spouses, or makes a transfer in which he retains a reversionary interest. This rule is similar to that presently contained in section 1230.

The present basis rules of section 1015 applying to gifts will be revised to provide an increased basis for property transferred by gift to the extent of the gain recognized at the time of the gift.

Certain exceptions corresponding to the exceptions discussed above in the death situation will be applicable. First, there will be an annual exception for ordinary personal household effects (see 4(b) above). Second, there will be an exception for charitable gifts subject to the same rules as apply to deathtime transfers. Third, there will be a marital exclusion on gifts between husband and wife so as to produce a result comparable to that produced by the marital exclusion on transfers at death.

Losses will be treated as sustained by reason of a gift and deductible under the usual rules. However, the gift will be considered to be the same as a sale for purposes of applying section 267 (which prevents losses from being realized on sales or exchanges between related parties).

Unlike the death situation, no special rule automatically according the donor the longest applicable holding period will be available. The actual holding period of the donor will be used in determining whether the gain was long term or short term, the amount of ordinary income in gain on depreciable real estate, etc. The gift in this regard will be treated like any other sale.

Further, it is not necessary to provide for liquidity problems in connection with gifts since a gift is a voluntary event and taxpayers will be able to provide for payment of the tax.

Under present law, taxpayers may sell appreciated property for a private annuity and realize no gain on the sale or exchange, on the theory that the value of the private annuity cannot be ascertained. Since this arrangement would be likely to receive increased use in order to avoid the capital gain tax on transfers of appreciated property, it is appropriate to change present law by providing that the sale will be taxed. The approach to be taken will be, in general, to value the private annuity received as if it were a commercial one.

8. FUTURE INTERESTS

The purpose of taxing gain on the appreciation in value of assets at appropriate times such as gift or death could easily be frustrated if assets were transferred in a form that would pass the gain untaxed through several generations. In order to foreclose such a result, a special rule will impose an income tax on appreciation in value on specific occasions, unless it is certain on the date of the original transfer that outright ownership, or its equivalent, of the transferred property will pass under the transfer to a person who is one degree lower than, or in the same degree as, or in a higher degree than, the transferor. If on the date of the transfer, property may be distributed

to a person who is outside the above group, for example, a grandchild, then appreciation in value will be taxed on each such distribution made in kind. In any event, a tax will be imposed on appreciation in value at the time of the death of the last surviving beneficiary who is in an equal, higher, or one lower degree than the transferor. In the case of a transfer for the benefit of persons who are not related to the original transferor, the gain on appreciated assets will be taxed upon distribution of such assets, and every 20 years in the case of assets not distributed.

In the case of a trust the tax will be payable by the trustee out of trust property. In the case of legal estates, the tax will be paid by the personal representative of the decedent whose death gives rise to the taxation of gain. The personal representative is not, however, personally liable for the tax and the tax is a lien only against the property itself.

For example, if A transfers property to B for life, remainder to C, who is A's son, no income tax will be imposed upon B's death under this special rule (A's transfer would result in tax to the extent of appreciation in value.) But if A transfers property in trust, the income to be paid to A's wife or A's children in the discretion of the trustee, with ultimate distribution to the grandchildren of A, per stirpes, upon attaining age 21, the special rule would impose, in addition to the tax on the transfer by A, tax on appreciation in value upon the death of A's last surviving child. Any distribution in kind to A's grandchildren during the lifetimes of A's children would also result in taxation of gain. The tax would be paid by the trustee. There is no taxation on the ultimate distribution to A's grandchildren after the death of A's last surviving child. (However, if A's greatgrandchildren were to take upon the death of the last surviving grandchild, then the rule would start operating again upon the death of A's last surviving child. That is, distributions in kind to greatgrandchildren while grandchildren were living would be taxable, and a tax on appreciation in value would be imposed on the death of the last surviving grandchild). An increase in basis would, of course, accompany each taxable event.

Losses will be allowed in cases where future interests are created upon the same occasions that require taxation of gain. In the case of legal estates, any loss will be reported by the personal representative of the decedent whose death gives rise to the taxation of gain but the loss will be deemed to be a long-term capital loss distributed to the remaindermen pro rata to their interests in the property. During the existence of a trust, losses will be allowed at the specified occasions and net losses will be carried forward in the trust. Upon termination of the trust, net losses will be carried over to the beneficiaries under section 642. Thus, if A transfers a legal interest in stock to his son B for life, then to his grandson C, any gain will be taxed on A's transfer, and if the property has depreciated in value upon B's death, any loss will be allowed and carried over as long-term capital loss in C's hands. If the property had been placed in trust, the loss is carried over to C under section 642.

The basis of loss property in the hands of a distributee will be governed by present rules under section 1015.

9. EFFECTIVE DATE

The new rule should apply to transfers by gift or by death after December 31, 1969.

For purposes of computing gain on property acquired before the date of enactment the taxpayer, or his personal representative, will have the option of using as his basis, either:

(1) Adjusted basis as computed under existing rules; or

(2) The value on the date of enactment as adjusted under present rules for any changes occurring after that date, including the depreciation or depletion (cost or percentage) actually taken after such date. This option will not apply to items giving rise to the taxation of ordinary income under the rules of section 8 above. Gain on such items will be computed from the adjusted basis (as determined under existing rules) without regard to the special rules set forth in this paragraph.

For purposes of computing losses on property acquired before the date of enactment the basis is the lower of (1) or (2) above.

Of course, the basis for property acquired after the date of enactment is its cost.

The need for tacking rules will be considerably reduced because of the increased number of events which produce taxation of gain under the new rules. When applicable, present tacking rules will continue to apply.

VIII-B. UNLIMITED MARITAL DEDUCTION AND UNIFICATION OF ESTATE AND GIFT TAXES

GENERAL EXPLANATION

PRESENT LAW

Under present law a Federal estate tax is imposed upon property transferred at death. The estate tax utilizes a progressive rate structure, so that the larger the estate, the higher the rate of tax. Property which is transferred during lifetime is not subject to the estate tax. In order to prevent avoidance of the estate tax by the transfer of property before death, present law also imposes a gift tax upon lifetime transfers. This is also a progressive tax, the rate increasing with the cumulative lifetime total of property transferred. But the estate tax is separate from the gift tax so that even where there are lifetime transfers the estate tax starts all over again with a new exemption and a new rate schedule. This present dual transfer tax structure contains a number of inequitable and unwarranted preferences for lifetime gifts, as opposed to transfers at death. These preferences increase in magnitude with the size of the estate involved; the larger the estate the greater the tax advantage for lifetime gifts. This situation is not only inequitable, but it reduces the intended progressivity of the transfer tax structure.

EXHIBIT B

General Explanations
of the
Administration's Fiscal Year 2016
Revenue Proposals



Department of the Treasury
February 2015

REFORM THE TAXATION OF CAPITAL INCOME

Current Law

Capital gains are taxable only upon the sale or other disposition of an appreciated asset. Most capital gains and dividends are taxed at graduated rates, with 20 percent generally being the highest rate. In addition, higher-income taxpayers are subject to a tax of 3.8 percent of the lesser of net investment income, including capital gains and dividends, or modified AGI in excess of \$200,000 (\$250,000 for married couples filing jointly and \$125,000 for married persons filing separately).

When a donor gives an appreciated asset to a donee during life, the donee's basis in the asset is its basis in the hands of the donor; there is no realization of capital gain by the donor at the time of the gift, and there is no recognition of capital gain by the donee until the donee later disposes of that asset. When an appreciated asset is held by a decedent at death, the decedent's heir receives a basis in that asset equal to its fair market value at the date of the decedent's death. As a result, the appreciation accruing during the decedent's life on assets that are still held by the decedent at death is never subjected to income tax.

Reasons for Change

Preferential tax rates on long-term capital gains and qualified dividends disproportionately benefit high-income taxpayers and provide many high-income taxpayers with a lower tax rate than many low- and middle-income taxpayers.

Because the person who inherits an appreciated asset receives a basis in that asset equal to the asset's fair market value on the decedent's death, the appreciation that accrued during the decedent's life is never subjected to income tax. In contrast, less-wealthy individuals who must spend down their assets during retirement must pay income tax on their realized capital gains. This increases the inequity in the tax treatment of capital gains. In addition, the preferential treatment for assets held until death produces an incentive for taxpayers to inefficiently lock in portfolios of assets and hold them primarily for the purpose of avoiding capital gains tax on the appreciation, rather than reinvesting the capital in more economically productive investments.

Proposal

The proposal would increase the highest long-term capital gains and qualified dividend tax rate from 20 percent to 24.2 percent. The 3.8 percent net investment income tax would continue to apply as under current law. The maximum total capital gains and dividend tax rate including net investment income tax would thus rise to 28 percent.

Under the proposal, transfers of appreciated property generally would be treated as a sale of the property. The donor or deceased owner of an appreciated asset would realize a capital gain at the time the asset is given or bequeathed to another. The amount of the gain realized would be the excess of the asset's fair market value on the date of the transfer over the donor's basis in that asset. That gain would be taxable income to the donor in the year the transfer was made, and to

the decedent either on the final individual return or on a separate capital gains return. The unlimited use of capital losses and carry-forwards would be allowed against ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate (if any). Gifts or bequests to a spouse or to charity would carry the basis of the donor or decedent. Capital gain would not be realized until the spouse disposes of the asset or dies, and appreciated property donated or bequeathed to charity would be exempt from capital gains tax.

The proposal would exempt any gain on all tangible personal property such as household furnishings and personal effects (excluding collectibles). The proposal also would allow a \$100,000 per-person exclusion of other capital gains recognized by reason of death that would be indexed for inflation after 2016, and would be portable to the decedent's surviving spouse under the same rules that apply to portability for estate and gift tax purposes (making the exclusion effectively \$200,000 per couple). The \$250,000 per person exclusion under current law for capital gain on a principal residence would apply to all residences, and would also be portable to the decedent's surviving spouse (making the exclusion effectively \$500,000 per couple).

The exclusion under current law for capital gain on certain small business stock would also apply. In addition, payment of tax on the appreciation of certain small family-owned and family-operated businesses would not be due until the business is sold or ceases to be family-owned and operated. The proposal would further allow a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made.

The proposal also would include other legislative changes designed to facilitate and implement this proposal, including without limitation: the allowance of a deduction for the full cost of appraisals of appreciated assets; the imposition of liens; the waiver of penalty for underpayment of estimated tax if the underpayment is attributable to unrealized gains at death; the grant of a right of recovery of the tax on unrealized gains; rules to determine who has the right to select the return filed; the achievement of consistency in valuation for transfer and income tax purposes; and a broad grant of regulatory authority to provide implementing rules.

To facilitate the transition to taxing gains at death and gift, the Secretary would be granted authority to issue any regulations necessary or appropriate to implement the proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable.

This proposal would be effective for capital gains realized and qualified dividends received in taxable years beginning after December 31, 2015, and for gains on gifts made and of decedents dying after December 31, 2015.

EXHIBIT C

[JOINT COMMITTEE PRINT]

**DESCRIPTION OF CERTAIN REVENUE PROVISIONS
CONTAINED IN THE PRESIDENT'S
FISCAL YEAR 2016 BUDGET PROPOSAL**

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



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JCS-2-15

PART XI – REFORMS TO CAPITAL GAINS TAXATION, UPPER-INCOME TAX BENEFITS, AND THE TAXATION OF FINANCIAL INSTITUTIONS

A. Reduce the Value of Certain Tax Expenditures

This proposal is substantially similar to a proposal found in the President’s fiscal year 2014 budget proposal, which modified prior years’ proposals. The modification is described in Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President’s Fiscal Year 2014 Budget Proposal* (JCS-4-13), December 2013, p. 98. The original proposal is described in Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President’s Fiscal Year 2013 Budget Proposal* (JCS-2-12), June 2012, pp. 219-228. The estimated budget effect of the current proposal can be found at Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2016 Budget Proposal* (JCX-50-15), March 6, 2015, Item XI.A, reprinted in the back of this volume.

B. Reform the Taxation of Capital Income by Modifying the Tax Rate for Long-Term Capital Gains and Qualified Dividends and Treating a Transfer of Appreciated Property by Gift or Bequest as a Sale of the Property

Present Law

Taxation of capital gains and dividends

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to \$3,000 of ordinary income in each year.³⁷⁹ Any remaining unused capital losses may be carried forward indefinitely to another taxable year.³⁸⁰

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business, (2) depreciable or real property used in the taxpayer’s trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions,

³⁷⁹ Sec. 1211(b).

³⁸⁰ Sec. 1212(b).

and (8) business supplies.³⁸¹ In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

A maximum rate applies to capital gains and dividends.³⁸² For 2015, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent on any amount of gain that otherwise would be taxed at a 39.6 percent rate. In addition, any adjusted net capital gain otherwise taxed at a 10- or 15-percent rate is taxed at a zero-percent rate. Adjusted net capital gain otherwise taxed at rates greater than 15 percent but less than 39.6 percent is taxed at a 15-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax. Dividends are generally taxed at the same rate as capital gains.

Tax on net investment income

An additional tax is imposed on net investment income in the case of an individual, estate, or trust.³⁸³ In the case of an estate or trust, the tax is 3.8 percent of the lesser of the undistributed net investment income or the excess of the adjusted gross income over the dollar amount at which the highest tax bracket in section 1(e) begins. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount. The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual filing a separate return, and \$200,000 in any other case. Thus, for taxpayers with sufficient income to trigger a net investment income tax, the rate on certain capital gains and dividends is 23.8 percent.

Net investment income is the excess of (1) the sum of (a) gross income from interest, dividends, annuities, royalties, and rents, other than such income which is derived in the ordinary course of a trade or business that is not a passive activity with respect to the taxpayer or a trade or business of trading in financial instruments or commodities, and (b) net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in the active conduct of a trade or business that is not in the trade or business of trading in financial instruments or commodities, over (2) deductions properly allocable to such gross income or net gain.

³⁸¹ Sec. 1221.

³⁸² Sec. 1(h).

³⁸³ Sec. 1411.

Income tax basis in property acquired from a decedent or received by gift

In general

Gain or loss, if any, on the disposition of property is measured by the taxpayer's amount realized (*i.e.*, gross proceeds received) on the disposition, less the taxpayer's basis in such property. Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

A gift or bequest of appreciated (or loss) property is not an income tax realization event for the transferor. In addition, the value of property received by gift and bequest is excluded from the recipient's gross income.³⁸⁴

Basis in property received by lifetime gift

Under present law, property received from a donor of a lifetime gift generally takes a carryover basis.³⁸⁵ "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift. If a donor's basis in property is greater than the fair market value of the property on the date of the gift, then, for purposes of determining loss on a subsequent sale of the property, the donee's basis is the property's fair market value on the date of the gift.

Basis in property acquired from a decedent

Property acquired from a decedent generally takes a stepped-up basis.³⁸⁶ "Stepped-up basis" means that the basis of property acquired from a decedent generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). Providing a fair market value basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent's death and eliminates the tax benefit from any unrealized loss.

In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent and, thus, is eligible for stepped-up basis. Thus, both the decedent's one-half share and the surviving

³⁸⁴ Sec. 102.

³⁸⁵ See sec. 1015.

³⁸⁶ See sec. 1014.

spouse's one-half share are stepped up to fair market value as of the decedent's death. This rule applies if at least one-half of the community interest is includible in the decedent's gross estate.

Stepped-up basis treatment generally is denied to certain interests in foreign entities. Stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that stock of a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped-up basis.³⁸⁷ Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped-up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (*i.e.*, generally the date of the decedent's death unless an alternate valuation date is elected).

Description of Proposal

Modification of tax rates

The proposal increases the highest long-term capital gains and qualified dividends rate from 20 percent to 24.2 percent. As a result, the maximum total tax rate on capital gains and dividends under the proposal (including the 3.8 percent tax on net investment income) is 28 percent.

Treat a transfer of appreciated property as a sale of the property

The proposal generally treats a transfer of appreciated property by gift or bequest as a sale of the property. As a result, the donor of a lifetime gift realizes a capital gain at the time of a gift, and the deceased owner of an asset realizes a capital gain at the time an asset is bequeathed to an heir or to another beneficiary. The amount realized is the excess of the fair market value of the asset on the date of the gift or bequest over the donor or decedent's basis in the asset. The gain is taxable to a donor of a lifetime gift in the year the gift is made and to a decedent either on the decedent's final individual income tax return or on a separate capital gains return. The unlimited use of capital losses and carryforwards is allowed against ordinary income on the decedent's final income tax return, and the tax imposed on gains deemed realized at death would be deductible on the estate tax return of the decedent's estate (if any). Gifts or bequests to a spouse or charity would carry the basis of the donor or decedent. In the case of a gift or bequest to a spouse, gain is not realized until the spouse disposes of the asset or dies. In the case of a gift or bequest of appreciated property to charity, any gain is exempt from capital gains tax.

The proposal exempts from taxation the gain on tangible personal property such as household furnishings and personal effects (excluding collectibles). In addition, the proposal provides for a \$100,000 (indexed for inflation after 2016) per-person exclusion of other capital gains recognized by reason of death. Any portion of a decedent's \$100,000 exclusion that remains unused at death may be "ported" to and used by the decedent's surviving spouse to

³⁸⁷ See secs. 1291(e) and 1296(i).

offset gain on bequests made by the surviving spouse at death,³⁸⁸ making the exclusion effectively \$200,000 for a married couple. The \$250,000 per-person exclusion under present law for capital gain on a principal residence would apply to all residences and also would be portable to a decedent's surviving spouse (making the exclusion effectively \$500,000 for a married couple).

The present-law exclusion for capital gain on certain small business stock also would apply. In addition, in the event of a gift or bequest of an interest in certain small family-owned and family-operated businesses, payment of tax on the gain is deferred and is not payable until the business is sold or ceases to be family-owned and operated. The proposal also provides for a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made.

The proposal describes other legislative changes that would be necessary to facilitate and implement the proposal, including:

1. the allowance of a deduction for the full cost of appraisals of appreciated assets;
2. the imposition of liens;
3. the waiver of penalties for underpayment of estimated tax if the underpayment is attributable to unrealized gains at death;
4. the grant of a right of recovery of the tax on unrealized gains;
5. rules to determine who has the right to select the return filed; and
6. rules requiring consistency in valuation for transfer and income tax purposes.

The proposal grants to the Secretary broad regulatory authority to issue any regulations necessary or appropriate to implement the proposal, including rules and safe harbors for determining the basis of assets in cases where complete records are not available.

Effective date.—The proposal is effective for capital gains realized and qualified dividends received in taxable years beginning after December 31, 2015, and for gains on gifts made and of decedents dying after December 31, 2015.

The estimated budget effect of this proposal can be found at Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2016 Budget Proposal* (JCX-50-15), March 6, 2015, Item XI.B, reprinted in the back of this volume.

³⁸⁸ Rules similar to the present-law estate tax portability rules would apply. See secs. 2010(c)(2)(B), (4), and (5).

Analysis

Modification of tax rates

For a detailed discussion of issues relating to modifying tax rates on capital gains and qualified dividends, see the Joint Committee staff's analysis of the Administration's fiscal year 2013 budget proposal.³⁸⁹

Treat a transfer of appreciated property as a sale of the property

Overview

The proposal (referred to below as the Administration's "deemed-realization" proposal) treats a transfer of appreciated property by gift or at death as a sale, resulting in immediate realization of gain and the imposition of a capital gains tax on the transferor. At the same time, the Administration proposes to retain the present-law estate, gift, and generation-skipping transfer taxes, but in a more robust form, with a higher top marginal tax rate and lower exemption levels.³⁹⁰

By way of example, assume that a single taxpayer who has used all of his lifetime exclusion from the estate tax dies in 2016 owning only publicly traded stock with a fair market value of \$2.1 million and a basis of \$1 million, which he bequeaths to his children. Under the proposal, the decedent would pay a capital gains tax of \$280,000 (28 percent³⁹¹ x (\$1.1 million gain - \$100,000 exclusion from gain)) on his final income tax return or on a separate capital gains tax return. The decedent's estate also is required to pay estate tax at a rate of 45 percent (*i.e.*, the increased estate tax rate provided in a separate fiscal year 2016 budget proposal), but in determining its estate tax liability may deduct the capital gains tax triggered by the deemed realization. Therefore, the estate's estate tax liability (disregarding any other available deductions or credits) is \$819,000 (45 percent x (\$2.1 million fair market value - \$280,000 deduction for gains taxes paid)).

Because the capital gains tax on the deemed realization is deductible for estate tax purposes and therefore reduces a decedent's estate tax liability, one might say that the effective Federal tax rate on the capital gain is lower than 28 percent -- in the above example, 15.4 percent (((\$280,000 tax on gain - 126,000 estate tax savings) / \$1 million gain).

³⁸⁹ Joint Committee on Taxation, *Description of Revenue Provisions Contained in the President's Fiscal Year 2013 Budget Proposal* (JCS-2-12), June 2012, pp. 205-219.

³⁹⁰ Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* (February 2015), pp. 193-194. The separate budget proposal generally retains the estate, gift, and generation-skipping transfer taxes, but increases the top tax rate to 45 percent and reduces the exclusions to \$3.5 million for estate and generation-skipping transfer tax purposes and \$1 million for gift tax purposes.

³⁹¹ The example assumes that the taxpayer's income exceeds the threshold for the 3.8 tax on net investment income, such that his total capital gains rate, as increased under the Administration's proposal, is 28 percent.

As described in greater detail below, the articulated goals of the Administration's deemed-realization proposal are to increase fairness and economic efficiency in the tax code.

Past efforts to treat a transfer by gift or at death as a realization event

Prior Treasury Proposals.—The Treasury Department has, on at least two prior occasions (in 1969 and 1977), issued proposals to tax unrealized appreciation when an asset is transferred by gift or at death. Neither proposal was enacted.

In 1969, the staff of the Treasury Department, as part of a study on tax reform, presented a number of proposals to Congress, including a proposal that was similar in many respects to the current deemed-realization proposal.³⁹² The 1969 proposal, like the present proposal, generally would tax as capital gain any unrealized appreciation in assets that are transferred by gift or at death. Other significant similarities include an exemption for smaller amounts of gain (stated as a minimum basis of \$60,000 under the 1969 proposal) and complete exemptions for transfers to a spouse or to charity.

Unlike the current proposal, the 1969 proposal did not specify that tax related to interests in family-owned and -controlled businesses would be deferred. In addition, the 1969 proposal included a transition rule under which only appreciation occurring after the date of enactment would be subject to tax, whereas the new proposal includes no such transition rule.³⁹³ Both the 1969 proposal and the new proposal contemplate the continued existence of an estate tax as a separate, additional tax, but the 1969 proposal contemplated using any revenue gains achieved under the proposal to reduce the estate tax burden, whereas the fiscal year 2016 budget proposes to expand the estate tax by increasing the top estate and gift tax rate and reducing the lifetime estate and gift tax exclusions.

In 1977, the Treasury Department issued a document entitled “Blueprints for Basic Tax Reform,” a result of a year-long study of ways to develop an ideal income tax base that takes into account all possible forms of income.³⁹⁴ Similar to the 1969 proposal, the 1977 Blueprint suggests treating a transfer by gift or at death as a realization event and imposing tax on the transferor at the rates applicable to other types of capital gains.³⁹⁵ The proposal includes little detail, aside from a transition rule similar to the transition rule included in the 1969 proposal,

³⁹² See Committee Print, Joint Publication of the House Committee on Ways and Means and the Senate Committee on Finance, *Tax Reform Studies and Proposals*, U.S. Treasury Department (February 5, 1969), Part 1, pp. 28-29.

³⁹³ One could argue that the absence of a transition rule raises a question of fairness for taxpayers who have made decisions based on present law to retain appreciated assets in anticipation of death. On the other hand, taxing only appreciation that occurs after the effective date could be administratively complex, requiring a valuation of all property not only at the time of sale, but also as of the effective date of the proposal.

³⁹⁴ Department of the Treasury, *Blueprints for Basic Tax Reform* (January 17, 1977).

³⁹⁵ *Ibid.*, p. 204.

under which the portion of gain deemed to have accrued prior to the effective date would be exempt from capital gains tax.

Examples from other countries.—Certain other countries, including Canada and Australia, tax capital gains on transfers at death and/or by gift. These countries employ a deemed-realization approach as a primary method of taxing transfers of wealth; they do not impose separate, additional taxes on transfers of wealth, such as estate or inheritance taxes.

Australia, for example, has no inheritance, estate, or gift tax. However, the transfer of capital assets generally is subject to Australia’s capital gains tax (“CGT”). Under the CGT, lifetime gifts are taxed similarly to capital assets sold for profit. Testamentary transfers of capital assets, however, generally are not subject to the CGT and consequently there is no realization of gain on assets transferred at the time of death. Recipients generally take the transferor’s basis in property (*i.e.*, the transferor’s basis is carried over to the recipient).³⁹⁶

Canada also has no formal gift, estate, or inheritance tax. The deemed distribution provisions of Canada’s Income Tax Act (“ITA”), however, impose a tax on capital gains of the decedent unrealized at the time of his death. In Canada, a decedent is deemed to have disposed of all property owned immediately before death. Depending on the property involved, this deemed disposition may cause the decedent to recognize income, recaptured depreciation, or capital gains. Transfers to a surviving spouse generally take a carryover basis, with any gain that accrued before the death of the decedent being deferred until it is realized by the surviving spouse.³⁹⁷

Policy arguments for or against treating a transfer by gift or at death as a realization event

Fairness/equity.—In describing its deemed-realization proposal, the Treasury Department first asserts that, because of inequities that exist in the current system for taxing gains, the proposal is necessary to help restore fairness:

Because the person who inherits an appreciated asset receives a basis in that asset equal to the asset’s fair market value on the decedent’s death, the appreciation that accrued during the decedent’s life is never subjected to income tax. In contrast, less-wealthy individuals who must spend down their assets during

³⁹⁶ For a description of the application of the Australian CGT to gifts and transfers at death, see <https://www.ato.gov.au/General/Capital-gains-tax/In-detail/Gifts,-inheritances-and-deceased-estates/Deceased-estate-and-CGT/>. See also Joint Committee on Taxation, *Description and Analysis of Alternative Wealth Transfer Tax Systems* (JCX-22-08), March 10, 2008, pp. 11-13.

³⁹⁷ For a description of Canada’s income taxation of deemed realizations at death, see <http://www.cra-arc.gc.ca/tx/ndvdl/lf-vnts/dth/dmd/menu-eng.html>. See also Joint Committee on Taxation, *Description and Analysis of Alternative Wealth Transfer Tax Systems* (JCX-22-08), March 10, 2008, pp. 11-13.

retirement must pay income tax on their realized capital gains.
This increases the inequity in the tax treatment of capital gains.³⁹⁸

The Treasury Department made a similar equity-based argument in support of its 1969 deemed-realization proposal:

[T]here is obvious and gross inequality in the income tax treatment of people who accumulate their estates by means of untaxed appreciation or value as compared to those who accumulate out of currently taxable income. Vast portions of capital gains . . . fall completely outside the income tax system.³⁹⁹

A tax on deemed realizations would attempt to address this perceived inequity by ensuring that taxpayers who transfer assets by gift or at death cannot permanently avoid tax on any accrued gains. A taxpayer who gratuitously transfers an asset thus will be treated the same as a taxpayer who sells or exchanges the asset.⁴⁰⁰

Some might argue that imposing a capital gains tax on a transfer by gift or at death is overly burdensome, particularly when combined with a separate, additional estate tax. If, for example, an estate has limited liquidity to pay the estate tax -- such as where much of the value of the estate is in a family business or farm -- one might argue that imposition of an additional tax on the decedent's deemed realization could exacerbate the estate's cash flow burden, causing a diversion of scarce resources that are needed to run the business. The proposal, however, seeks to address this liquidity concern by providing special rules under which: (1) capital gains tax relating to an interest in a small family-owned and -operated business may be deferred until the business is sold or ceases to be family-operated; and (2) capital gains tax relating to certain illiquid assets may be paid over a period of 15 years.

Others might argue that, under present law, unrealized gain does not escape taxation, because the estate tax applies to the entire value of an asset included in the decedent's state. Adding a new tax on gains to the existing wealth transfer taxes, they would argue, is unnecessary and will result in double taxation of wealth transfers. The proposal, however, allows for the tax on a capital gains realization resulting from death to be deducted for estate tax purposes, ensuring that assets used to pay the capital gains tax are not also included in the estate tax base.

³⁹⁸ Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* (February 2015), p. 156. See also Michael J. Graetz, "Taxation of Unrealized Gains at Death--An Evaluation of the Current Proposals," *Virginia Law Review*, vol. 59, 1973, pp. 830, 833-35 (noting that several commentators have criticized the present-law system as inequitable to the extent that it treats gains on death differently from gains when assets are sold).

³⁹⁹ See Committee Print, Joint Publication of the House Committee on Ways and Means and the Senate Committee on Finance, *Tax Reform Studies and Proposals, U.S. Treasury Department* (February 5, 1969), Part 1, p. 28.

⁴⁰⁰ See American Bar Association, Task Force on Federal Wealth Transfer Taxes, *Report on Reform of Federal Wealth Transfer Taxes* (2004), p. 183.

Furthermore, the two taxes arguably serve different purposes: the estate and gift taxes impose a tax on transfers across generations, whereas the capital gains tax on deemed realizations taxes accrued gain that has been deferred under rules regarding realizations.⁴⁰¹

Reduce or eliminate the “lock-in” effect of present law.—The Treasury Department next argues that the present-law rules allowing for a step-up in basis at death are inefficient and impede the free flow of capital in the economy:

[T]he preferential treatment for assets held until death produces an incentive for taxpayers to inefficiently lock in portfolios of assets and hold them primarily for the purpose of avoiding capital gains tax on the appreciation, rather than reinvesting the capital in more economically productive investments.⁴⁰²

The Treasury Department also described this lock-in effect of present law in connection with its 1969 deemed-realization proposal:

When tax liability is allowed to depend on whether or not an appreciated asset is sold or kept until death, not only is there a serious inequity in the tax law, but, particularly in the case of older people, assets become immobilized. Investors become ‘locked in’ by the prospect of avoiding income tax completely if they hold appreciated assets until death rather than selling them. This freezing of investment positions curtails the essential mobility of capital in our economy and deprives it of the fruits of an unencumbered flow of capital toward areas of enterprise promising the largest rewards.⁴⁰³

In other words, the prospect of eliminating gains entirely at death artificially influences economic decisions regarding whether to hold or transfer assets during life.

At least one commentator, however, asserts that the extent of the lock-in effect of present law is unclear; therefore, any advantages of past proposals designed to reduce or eliminate the lock-in effect might be outweighed by the costs of added complexity.⁴⁰⁴ The commentator points out that any exceptions that would mitigate the effect of a proposal to tax gains at death — such as the \$60,000 deemed-basis rule included in the 1969 proposal — allow for lock-in to

⁴⁰¹ See David Kamin, “*How to Tax the Rich*,” Tax Notes (January 5, 2015), p. 126.

⁴⁰² Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals* (February 2015), p. 156.

⁴⁰³ See Committee Print, Joint Publication of the House Committee on Ways and Means and the Senate Committee on Finance, *Tax Reform Studies and Proposals, U.S. Treasury Department* (February 5, 1969), Part 1, p. 28.

⁴⁰⁴ See Graetz, *supra*, p. 836.

occur.⁴⁰⁵ As a result, a taxpayer who has an incentive to hold assets until death under present law likely would have an incentive to do so under a deemed-realization regime that provides for significant exceptions. The current proposal includes numerous such exceptions that arguably could reduce the proposal's effectiveness in eliminating the lock-in effect of present law, including: (1) a \$100,000 per person (portable to a surviving spouse) exemption; (2) a \$250,000 per person (portable to a surviving spouse) residence exclusion that is extended to all residences; and (3) a deferral rule for certain small family-owned and -controlled businesses.

Complexity.—As one commentator states, “[a]lthough the existing law which provides a step-up in basis without tax on unrealized gains is inequitable, it is quite simple.”⁴⁰⁶ Because present law imposes no tax on gains at death, the Administration's deemed-realization proposal necessarily would add complexity to the Code.

Indeed, under present law, any built-in gain in an asset owned by a decedent at the time of his death is wiped away, and the decedent's heir takes a basis equal to fair market value. There is no need to compare the date-of-death value to an historical basis figure; the decedent's basis in the asset becomes irrelevant. By contrast, under the proposal there will be a need to value gain assets as of the decedent's death (or at the time of a gift) to determine the amount of gain that will be deemed realized and thus taxed. This process will in some cases require costly appraisals and lead to valuation disputes, increasing compliance costs for taxpayers and the Service.

One commentator argues that valuation should not be viewed as a major concern, at least for the largest estates, because many assets will need to be valued in any event for estate tax purposes.⁴⁰⁷ Furthermore, taxpayers with smaller estates might avoid the new tax on deemed realizations entirely by reason of the various exclusions provided under the proposal, eliminating the need for such taxpayers' representatives to value any assets held at death. Nevertheless, because the exemption from the capital gains tax on deemed realizations (\$100,000 per person) falls well below the exclusion from estate tax (\$5.43 million for 2015), a substantial number of decedents whose estates need not file an estate tax return will be required to pay tax on gains deemed realized at death. These decedents' personal representatives must, as a result, determine the value of appreciated property owned by the decedent at the time of his death solely for purposes of determining the amount of tax arising from the deemed realization, which could prove especially burdensome if the taxpayer held non-publicly traded stock or other illiquid assets.

Even the Administration's description of the proposal provides a window into the complexity that would be added to the Code by using vague, undefined terms to describe key

⁴⁰⁵ *Ibid.*

⁴⁰⁶ *Ibid.*, p. 838.

⁴⁰⁷ Kamin, *supra*, p. 126 (“[F]rom an administrative point of view, the timing alignment is in fact a major boon. It allows the income tax system to take advantage of the estate tax's valuation requirements, at least for the highest-value estates.”).

concepts. For example, the deferral rules for “certain small family-owned and family-operated businesses” -- a term the Administration does not define -- are likely to be highly complex and, because of the attractiveness of the deferral benefit they provide, could become a significant source of disputes with the Service. The exemption rules regarding “household furnishings and personal effects (excluding collectibles)” are likely to present similar problems.

Furthermore, the Administration lists (but does not describe in detail) several legislative rules that would need to be drafted on top of the core elements of the proposal: (1) the allowance of a deduction for the full cost of appraisals of appreciated assets; (2) the imposition of liens; (3) the waiver of penalties for underpayment of estimated tax if the underpayment is attributable to unrealized gains at death; (4) the grant of a right of recovery of the tax on unrealized gains; (5) rules to determine who has the right to select the return filed; (6) rules requiring consistency in valuation for transfer and income tax purposes; and (7) a broad grant of general regulatory authority (including rules and safe harbors for determining the basis of assets in cases where complete records are unavailable). This list likely is not exhaustive.

Alternative proposals

Commentators have described other types of proposals designed to increase equity and reduce the lock-in effect as compared to the present-law basis step-up regime. Each may have advantages or disadvantages relative to the Administration’s deemed-realization proposal.

Mark-to market.—One option, for example, would be to implement a mark-to-market system, under which taxpayers would be required to account for periodic changes in value and pay tax annually on any gains.⁴⁰⁸ A mark-to-market system would have the advantage of making it more difficult for taxpayers to adjust realization behavior based on the income tax realization rules. Administrability, however, likely would be a significant obstacle to enacting such a system. The need to determine value on an annual basis could significantly increase taxpayers’ compliance costs and well as the cost to the IRS of administering the law.

Carryover basis for assets acquired from a decedent.—A second alternative to a deemed-realization system would be to require that the basis of an asset owned by a decedent at the time of his death be carried over to the decedent’s heir. Capital gains tax on any appreciation that accrued before the decedent died would be deferred and paid when the heir sells or disposes of the asset.

On two prior occasions, the Code has been modified to provide for a carryover basis for certain assets acquired from a decedent. First, the Tax Reform Act of 1976⁴⁰⁹ replaced the section 1014 basis step-up rules with rules that generally provided for the decedent’s basis to be carried over to the heir. The rules were short lived; under the weight of heavy criticism, they were repealed only four years later, in 1980.⁴¹⁰ Second, the Economic Growth and Tax Relief

⁴⁰⁸ *Ibid.*, pp. 122-123.

⁴⁰⁹ Pub. L. No. 94-455 (Oct. 4, 1976), sec. 2005.

⁴¹⁰ Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223 (April 2, 1980), sec. 401(a).

Reconciliation Act of 2001 (“EGTRRA”)⁴¹¹ provided for the phase-out and eventual temporary repeal of the estate tax. For decedents dying in 2010, the one year in which the estate tax was to be repealed, a new basis regime was to take effect. Specifically, taxpayers who acquired assets from a decedent who died during 2010 would take a modified carryover basis under which only a limited, specified amount of “step up” would be allowed for assets in the estate (generally, \$1.3 million plus an additional \$3 million for assets transferred to a spouse); other assets generally would take a carryover basis. In December 2010, however, the estate tax and step-up in basis rules were restored retroactively for decedents dying during 2010, although an executor was permitted to elect to have the EGTRRA rules apply to the estate and to the decedent’s heirs, *i.e.*, no estate tax would apply, but heirs would take a modified carryover basis rather than a stepped-up basis.⁴¹²

A carryover basis regime, like the deemed-realization proposal, would address concerns about equity by limiting opportunities to avoid permanently the tax on gains that accrue prior to a decedent’s death.⁴¹³ A carryover basis regime would not, however, place bequests completely on par with a sale of an asset during life, because gain still could be deferred indefinitely from one generation to the next. In this respect, bequests would be treated more like gifts, which take a carryover basis under present law.⁴¹⁴ Furthermore, a carryover basis regime for assets acquired from a decedent may not address the lock-in concern that arises under the present-law step-up in basis regime. Instead, a carryover basis requirement arguably would exacerbate the lock-in effect, as heirs in subsequent generations could face an ever increasing tax burden in the event of a sale (as values continue to rise over time, increasing the gap between fair market value and the initial decedent’s tax basis).⁴¹⁵

A carryover basis regime also might increase taxpayers’ compliance burdens and the costs to the IRS of administering the law. Executors, for example, would need to consider not only the equitable allocation of asset values across a decedent’s heirs, but also the allocation of basis across heirs. In addition, basis would in some cases have to be tracked across multiple generations, raising significant compliance concerns.⁴¹⁶ Finally, such a law would add complexity to the Code, because, to achieve consistency with sales of appreciated property

⁴¹¹ Pub. L. No. 107-16 (June 7, 2001), secs. 541 and 542.

⁴¹² Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312 (December 17, 2010), sec. 301.

⁴¹³ See Lawrence Zelenak, “Taxing Gains at Death,” *Vanderbilt Law Review*, vol. 46, 1993, p. 361, 367.

⁴¹⁴ See Graetz, *supra*, p. 833.

⁴¹⁵ See *ibid.*, p. 837.

⁴¹⁶ Zelenak, *supra*, p. 368.

before death, the tax basis in property would need to be increased by the portion of Federal and State death taxes that are attributable to the appreciation.⁴¹⁷

⁴¹⁷ Such concerns could be mitigated by, for example, requiring estates to provide basis information to heirs.

ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN
 THE PRESIDENT'S FISCAL YEAR 2016 BUDGET PROPOSAL [1]

Fiscal Years 2015 - 2025

[Millions of Dollars]

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
I. Make Permanent Certain Tax Cuts Enacted in 2009														
A. Reduce the Earnings Threshold for the Refundable Portion of the Child Tax Credit to \$3,000 [2].....	tyba 12/31/17	--	--	--	--	-12,373	-12,455	-12,452	-12,534	-12,597	-12,694	-12,733	-24,827	-87,839
B. Earned Income Tax Credit ("EITC") Modification and Simplification - Increase in Joint Returns Beginning and Ending Income Level for Phaseout by \$5,000, Indexed After 2008 [2].....	tyba 12/31/17	--	--	--	-16	-1,602	-1,596	-1,592	-1,593	-1,596	-1,605	-1,604	-3,214	-11,204
C. Extend the EITC for Larger Families [2].....	tyba 12/31/17	--	--	--	-25	-2,541	-2,601	-2,672	-2,733	-2,804	-2,897	-2,973	-5,167	-19,245
D. Extension of American Opportunity Tax Credit [2].....	tyba 12/31/17	--	--	--	-2,361	-11,791	-11,651	-11,327	-11,116	-10,739	-10,565	-10,316	-25,803	-79,866
Total of Make Permanent Certain Tax Cuts Enacted in 2009.....		--	--	--	-2,402	-28,307	-28,303	-28,043	-27,976	-27,736	-27,761	-27,626	-59,011	-198,154
II. Reform U.S. International Tax System														
A. Restrict Deductions for Excessive Interest of Members of Financial Reporting Groups.....	tyba 12/31/15	--	2,812	5,340	5,683	5,977	6,348	6,780	7,180	7,561	8,029	8,525	26,161	64,236
B. Provide Tax Incentives for Locating Jobs and Business Activity in the United States and Remove Tax Deductions for Shipping Jobs Overseas.....	epoia DOE	-2	-11	-20	-23	-24	-25	-26	-27	-28	-30	-31	-105	-247
C. Repeal Delay in the Implementation of Worldwide Interest Allocation.....	tyba 12/31/15	--	-882	-1,787	-1,825	-1,782	-1,765	-963	106	53	13	--	-8,041	-8,832
D. Permanently Extend the Exception under Subpart F for Active Financing Income.....	[3]	-3,101	-6,535	-6,671	-6,553	-6,710	-6,634	-6,785	-7,412	-7,664	-7,598	-7,679	-36,204	-73,342
E. Permanently Extend the Look-Through Treatment of Payments between Related Controlled Foreign Corporations ("CFCs").....	[3]	-454	-694	-763	-833	-896	-967	-1,063	-1,164	-1,245	-1,346	-1,467	-4,607	-10,893
F. Impose a 19-percent Minimum Tax on Foreign Income	tyba 12/31/15	--	15,298	29,993	28,339	28,194	28,887	29,731	28,204	26,101	24,788	22,724	130,710	262,259
G. Impose a 14-Percent One-Time Tax on Previously Untaxed Foreign Income.....	[4]	7,509	53,935	48,129	49,024	50,149	43,147	-8,068	-6,486	-6,693	-6,877	-6,586	251,895	217,185
H. Limit Shifting of Income through Intangible Property Transfers.....	tyba 12/31/15	--	87	185	205	227	251	276	304	333	365	399	955	2,631
I. Disallow the Deduction for Excess Non-Taxed Reinsurance Premiums Paid to Affiliates.....	pii tyba 12/31/15	--	297	718	766	816	869	923	981	1,043	1,108	1,178	3,466	8,700

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
J. Modify Tax Rules for Dual Capacity	generally													
Taxpayers.....	tyba 12/31/15	---	717	1,359	1,337	1,296	1,215	1,117	1,008	1,083	1,161	1,273	5,923	11,566
K. Tax Gain from the Sale of a Partnership Interest on Look-Through Basis.....	soea 12/31/15	---	159	234	245	255	266	277	289	301	314	327	1,159	2,666
L. Modify Sections 338(h)(16) and 902 To Limit Credits When Non-Double Taxation Exists.....	toa 12/31/15	---	52	92	95	97	100	103	106	110	114	118	437	988
M. Close Loopholes Under Subpart F.....	tyba 12/31/15	---	1,204	2,643	2,841	2,971	3,118	3,333	3,610	3,907	4,230	4,566	12,777	32,423
N. Restrict the Use of Hybrid Arrangements that Create Stateless Income.....	tyba 12/31/15	---	125	227	252	267	283	304	325	341	362	387	1,154	2,873
O. Limit the Ability of Domestic Entities to Expatriate.....	Tea 12/31/15 & 1/1/16	---	135	463	738	1,031	1,337	1,646	2,040	2,452	2,884	3,615	3,703	16,340
Total of Reform U.S. International Tax System.....		3,952	66,699	80,142	80,291	81,868	76,430	27,585	29,064	27,655	27,517	27,349	389,383	528,553
III. Simplification and Tax Relief for Small Business														
A. Expand and Permanently Extend Increased Expensing for Small Business.....	qppisi tyba 12/31/14	-7,843	-17,169	-16,349	-12,510	-9,726	-7,633	-6,372	-5,210	-5,077	-5,787	-5,966	-71,230	-99,643
B. Expand Simplified Accounting for Small Business and Establish a Uniform Definition of Small Business for Accounting Methods.....	tyba 12/31/15 & 12/31/16	---	-3,448	-3,715	-2,932	-2,456	-2,269	-2,210	-2,121	-2,023	-1,927	-1,833	-14,819	-24,934
C. Eliminate Capital Gains Taxation on Investments in Small Business Stock.....	qsbsaa 12/31/14	2	15	15	16	16	-215	-1,546	-1,645	-1,727	-1,804	-1,654	-151	-8,526
D. Increase the Limitations for Deductible New Business Expenditures and Consolidate Provisions for Start-Up and Organizational Expenditures.....	tyba 12/31/15	---	-39	-98	-138	-179	-222	-267	-314	-362	-413	-499	-675	-2,530
E. Expand and Simplify the Tax Credit Provided to Qualified Small Employers for Non-Elective Contributions to Employee Health Insurance [2].....	tyba 12/31/14	-95	-157	-147	-187	-127	-135	-229	-246	-256	-268	-282	-849	-2,129
Total of Simplification and Tax Relief for Small Business.....		-7,936	-20,798	-20,294	-15,751	-12,472	-10,474	-10,624	-9,536	-9,445	-10,199	-10,234	-87,724	-137,762
IV. Incentives for Manufacturing, Research, and Clean Energy														
A. Enhance and Make Permanent Research Incentives.....	Epoia 12/31/15	-2,737	-7,223	-10,288	-12,437	-14,479	-16,427	-18,280	-20,103	-21,854	-22,970	-23,938	-63,592	-170,737
B. Extend and Modify Certain Employment Tax Credits, Including Incentives for Hiring Veterans														
1. Permanently extend and modify the work opportunity tax credit ("WOTC").....	wptqiwbwfttea 12/31/14 & 12/31/15	-390	-1,009	-1,313	-1,488	-1,628	-1,734	-1,814	-1,925	-2,042	-2,167	-2,364	-7,562	-17,875
2. Permanently extend and modify the Indian employment credit.....	wptqei tyba 12/31/14 & tyba 12/31/15	-22	-33	-15	-6	-2	-2	-2	-2	-2	-2	-2	-80	-91
C. Modify and Permanently Extend Renewable Electricity Production Tax Credit and Investment Tax Credit [2].....	powcoba 12/31/14	-13	-45	-825	-1,695	-2,553	-3,354	-4,118	-4,756	-5,401	-6,145	-6,875	-8,485	-35,780
D. Modify and Permanently Extend the Deduction for Energy-Efficient Commercial Building Property.....	ppisa 12/31/15	-168	-363	-527	-693	-708	-726	-719	-694	-697	-687	-667	-3,185	-6,648

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
E. Provide a Carbon Dioxide Investment and Sequestration Tax Credit [2].....	DOE	---	---	---	-176	-404	-637	-914	-1,147	-995	-826	-817	-1,217	-5,915
F. Provide Additional Tax Credits for Investment in Qualified Property Used in a Qualified Advanced Energy Manufacturing Project.....	DOE	---	-406	-718	-393	-144	-103	-23	56	65	33	7	-1,764	-1,625
G. Provide New Manufacturing Communities Tax Credit.....	qjai 2016-2018	---	---	-4	-20	-68	-139	-209	-257	-287	-306	-299	-230	-1,587
H. Extend the Tax Credit for Second Generation Biofuel Production (sunset 12/31/24).....	fsoua 12/31/14	-12	-35	-62	-91	-112	-132	-137	-122	-98	-66	-24	-444	-889
Total of Incentives for Manufacturing, Research, and Clean Energy.....		-3,342	-9,114	-13,752	-16,999	-20,098	-23,254	-26,216	-28,950	-31,311	-33,136	-34,979	-86,559	-241,147
V. Incentives To Promote Regional Growth														
A. Modify and Permanently Extend the New Markets Tax Credit.....	DOE	-28	-107	-325	-436	-589	-763	-958	-1,178	-1,389	-1,542	-1,531	-2,247	-8,844
B. Reform and Expand the Low-Income Housing Tax Credit ("LIHTC")														
1. Allow states to convert private activity bond ("PAB") volume cap into LIHTCs that the State can allocate; and alternative qualification by building owners for PAB-related LIHTCs.....	[5]	---	-6	-45	-159	-348	-596	-887	-1,199	-1,517	-1,839	-2,145	-1,154	-8,741
2. Encourage mixed income occupancy by allowing LIHTC-supported projects to elect a criterion employing a restriction on average income.....	[6]	---	-3	-4	-5	-6	-7	-10	-11	-12	-13	-14	-25	-85
3. Change formulas for 70 percent PV and 30 percent PV LIHTCs.....	amo/a DOE	---	-6	-8	-11	-14	-16	-20	-22	-25	-27	-30	-55	-179
4. Add preservation of Federally assisted affordable housing to allocation criteria.....	ami cyba DOE	----- Negligible Revenue Effect -----												
5. Remove the qualified Census tract population cap.....	DOE	---	-5	-7	-8	-10	-12	-16	-18	-20	-22	-24	-42	-142
6. Implement requirement that LIHTC-supported housing protect victims of domestic abuse.....	[7]	----- Negligible Revenue Effect -----												
Total of Incentives To Promote Regional Growth.....		-28	-127	-389	-619	-967	-1,394	-1,891	-2,428	-2,963	-3,443	-3,744	-3,523	-17,991
VI. Incentives for Investment in Infrastructure														
A. Provide America Fast Forward Bonds and Expand Eligible Uses [2].....	bio/a 1/1/16	---	-7	-55	-143	-239	-340	-448	-563	-681	-802	-927	-785	-4,206
B. Allow Current Refundings of State and Local Governmental Bonds.....	DOE	----- Negligible Revenue Effect -----												
C. Repeal the \$150 Million Nonhospital Bond Limitation on all Qualified 501(c)(3) Bonds.....	bia DOE	[8]	-1	-2	-4	-6	-8	-11	-13	-15	-18	-20	-22	-99
D. Increase National Limitation Amount for Qualified Highway or Surface Freight Transfer Facility Bonds.....	DOE	[8]	[8]	-1	-7	-15	-24	-33	-41	-43	-43	-42	-48	-250

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
E. Provide a New Category of Qualified Private Activity Bonds for Infrastructure Projects Referred to as "Qualified Public Infrastructure Bonds"	bis 1/1/16	--	-16	-81	-182	-291	-406	-527	-649	-772	-897	-1,024	-976	-4,845
F. Modify Qualified Private Activity Bonds for Public Educational Facilities	bia DOE	-4	-25	-58	-68	-80	-90	-100	-110	-120	-131	-142	-325	-928
G. Modify Treatment of Banks Investing in Tax-Exempt Bonds	bii cybo/a 1/1/16	--	-57	-138	-233	-325	-409	-476	-528	-573	-612	-647	-1,162	-3,998
H. Repeal Tax-Exempt Bond Financing of Professional Sports Facilities	bia 12/31/15	--	1	7	15	24	34	45	56	68	80	93	81	423
I. Allow More Flexible Research Arrangements for Purposes of Private Business Use Limits	raeia DOE	[8]	[8]	-1	-3	-5	-7	-9	-11	-14	-16	-18	-16	-84
J. Modify Tax-Exempt Bonds for Indian Tribal Governments	DOE	-1	-3	-7	-11	-15	-20	-26	-31	-37	-43	-49	-55	-241
K. Exempt Certain Foreign Pension Funds from the Application of the Foreign Investment in Real Property Tax Act ("FIRPTA")	doUSrpioa 12/31/15	--	-91	-146	-165	-178	-192	-206	-222	-239	-255	-272	-771	-1,965
Total of Incentives for Investment in Infrastructure		-5	-199	-482	-801	-1,130	-1,462	-1,791	-2,112	-2,426	-2,737	-3,048	-4,079	-16,193
VII. Eliminate Fossil Fuel Preferences														
A. Eliminate Oil And Natural Gas Preferences														
1. Repeal enhanced oil recovery ("EOR") credit	pocia 12/31/15	----- No Revenue Effect -----												
2. Repeal credit for oil and gas produced from marginal wells	pocia 12/31/15	----- No Revenue Effect -----												
3. Repeal expensing of intangible drilling costs	pocia 12/31/15	--	1,529	2,244	2,070	1,888	1,713	1,382	804	582	433	808	9,444	13,454
4. Repeal deduction for tertiary injectants	pocia 12/31/15	--	5	7	7	8	8	6	6	5	4	4	35	60
5. Repeal exception to passive loss limitations for working interests in oil and natural gas properties	pocia 12/31/15	--	11	22	23	23	24	24	25	25	26	26	103	229
6. Repeal percentage depletion for oil and natural gas wells	pocia 12/31/15	--	1,054	1,616	1,650	1,715	1,774	1,820	1,852	1,877	1,900	1,919	7,807	17,177
7. Repeal domestic manufacturing deduction for oil and natural gas production	pocia 12/31/15	--	387	1,022	1,163	1,258	1,279	1,300	1,330	1,368	1,411	1,462	5,109	11,980
8. Increase geological and geophysical amortization period for independent producers to seven years	pocia 12/31/15	--	44	156	232	217	170	123	75	42	32	29	819	1,120
9. Repeal exemption from the corporate income tax for publicly traded partnerships with qualifying income and gains from activities relating to fossil fuels	tyba 12/31/20	--	--	--	--	--	--	131	239	250	263	276	0	1,159
B. Eliminate Coal Preferences														
1. Repeal expensing of exploration and development costs	pocia 12/31/15	--	54	82	80	78	77	79	85	93	100	108	371	836
2. Repeal percentage depletion for hard mineral fossil fuels	pocia 12/31/15	--	39	62	66	69	72	74	77	79	82	84	308	704
3. Repeal capital gains treatment for royalties	Ara tyba 12/31/15	4	24	15	42	43	44	46	47	49	51	53	173	420

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
4. Repeal domestic manufacturing deduction for the production of coal and other hard mineral fossil fuels...	pocia 12/31/15	---	13	35	40	45	49	50	51	53	55	57	182	448
Total of Eliminate Fossil Fuel Preferences.....		4	3,160	5,261	5,373	5,344	5,210	5,035	4,591	4,423	4,357	4,826	24,351	47,587
VIII. Reform the Treatment of Financial and Insurance														
Industry Products														
A. Require that Derivative Contracts be Marked to Market with Resulting Gain or Loss Treated as Ordinary.....	dceia 12/31/15	---	533	3,405	2,498	2,091	1,839	1,486	1,332	1,218	1,096	997	10,366	16,496
B. Modify Rules that Apply to Sales of Life Insurance Contracts.....	[9]	---	40	52	64	76	90	107	120	137	158	177	322	1,021
C. Modify Proration Rules for Life Insurance Company General and Separate Accounts.....	tyba 12/31/15	---	186	509	555	609	670	683	697	711	726	740	2,529	6,086
D. Extend Pro Rata Interest Expense Disallowance for Corporate-Owned Life Insurance.....	[10]	---	45	191	385	479	629	765	953	1,100	1,290	1,350	1,729	7,187
E. Conform Net Operating Loss Rules of Life Insurance Companies to Those of Other Corporations.....	tyba 12/31/15	---	40	65	30	31	32	33	34	36	37	38	198	376
Total of Reform Treatment of Financial and Insurance Industry Products.....		---	844	4,222	3,532	3,286	3,260	3,074	3,136	3,202	3,307	3,302	15,144	31,166
IX. Other Revenue Changes and Loophole Closers														
A. Repeal Last-In, First-Out ("LIFO") Method of Accounting for Inventories.....	ftyba 12/31/15	---	5,426	10,869	10,906	10,943	10,981	11,020	11,059	11,100	11,141	11,183	49,125	104,628
B. Repeal Lower-Of-Cost-or-Market ("LCM") Inventory Accounting Method.....	tyba 12/31/15	---	513	1,026	1,027	1,029	556	83	85	86	88	90	4,151	4,583
C. Modify Like-Kind Exchange Rules for Real Property and Collectibles.....	lkeca 12/31/15	---	38	86	148	252	423	699	1,086	1,641	2,460	3,671	947	10,504
D. Modify Depreciation Rules for Purchases of General Aviation Passenger Aircraft.....	ppisa 12/31/15	---	92	318	504	567	635	659	487	269	170	146	2,116	3,847
E. Expand the Definition of Built-In Loss for Purposes of Partnership Loss Transfers.....	soea DOE	7	47	62	64	67	69	73	76	80	83	87	316	715
F. Extend Partnership Basis Limitation Rules to Nondeductible Expenditures.....	ptybo/a DOE	15	95	123	129	133	140	146	152	160	167	175	635	1,435
G. Limit the Importation of Losses Under Related Party Loss Limitation Rules.....	tma DOE	28	92	115	119	124	129	136	141	148	155	162	607	1,349
H. Deny Deduction for Punitive Damages.....	dpoia 12/31/15	---	27	37	38	39	40	42	43	44	45	47	181	402
I. Conform Corporate Ownership Standards.....	toa 12/31/15	---	14	20	20	20	21	22	23	24	25	26	95	215
J. Tax Corporate Distributions as Dividends.....	DOE & toa 12/31/15	---	28	80	82	84	87	89	91	94	95	96	361	826
K. Repeal Federal Insurance Contributions Act ("FICA") Tip Credit [11].....	tyba 12/31/15	---	552	983	1,084	1,172	1,239	1,300	1,365	1,434	1,505	1,540	5,031	12,176

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
L. Repeal the Excise Tax Credit for Distilled Spirits with Flavor and Wine Additives.....	aspioitUSA 12/31/15	--	89	119	120	120	121	121	122	122	123	123	568	1,179
Total of Other Revenue Changes and Loophole Closers.....		50	7,013	13,838	14,241	14,550	14,441	14,390	14,731	15,202	16,057	17,345	64,133	141,859
X. Tax Reform for Families and Individuals														
A. Reform Child Care Tax Incentives [2].....	tyba 12/31/15	--	-42	-4,180	-4,337	-4,506	-4,719	-4,909	-5,146	-5,383	-5,623	-5,873	-17,783	-44,717
B. Simplify and Better Target Tax Benefits for Education														
1. Expand and modify the AOTC and repeal Lifetime Learning Credits [2].....	tyba 12/31/15	--	-548	-2,732	-2,637	-2,543	-3,310	-3,902	-4,726	-4,816	-5,652	-6,591	-11,770	-37,457
2. Make Pell grants excludable from income [2].....	tyba 12/31/15	--	-30	-335	-615	-592	-575	-570	-561	-561	-558	-548	-2,146	-4,944
3. Modify reporting of tuition expenses and scholarships on Form 1098-T [2].....	tyba 12/31/15	--	5	45	48	51	54	57	60	64	67	69	203	520
4. Repeal the student loan interest deduction and provide exclusion for certain debt relief and scholarships [2].....	tyba 12/31/15 & dola 12/31/15	--	-4	-14	-14	-15	9	132	263	397	535	685	-37	1,976
5. Repeal Coverdells and reduce the Federal tax benefits of qualified tuition programs.....	tyba 12/31/15	----- <i>Proposal Withdrawn by the Administration</i> -----												
C. Provide for Automatic Enrollment in IRAs, Including a Small Employer Tax Credit, Increase the Tax Credit for Small Employer Plan Start-Up Costs, and Provide an Additional Tax Credit for Small Employer Plans Newly Offering Auto-enrollment [2].....	tyba 12/31/16	--	--	-561	-1,415	-1,460	-1,480	-1,470	-1,534	-1,610	-1,684	-1,754	-4,917	-12,968
D. Expand Penalty-Free Withdrawals for Long-Term Unemployed.....	edoa 12/31/15	--	-105	-144	-150	-160	-170	-178	-187	-195	-205	-214	-729	-1,708
E. Require Retirement Plans to Allow Long-Term Part-Time Workers to Participate [2].....	pyba 12/31/15	--	-35	-55	-64	-72	-83	-94	-106	-118	-130	-144	-309	-901
F. Facilitate Annuity Portability.....	pyba 12/31/15	----- <i>Negligible Revenue Effect</i> -----												
G. Simplify Minimum Required Distribution ("MRD") Rules.....	[12]	--	-7	-31	-40	-30	-5	22	59	105	161	227	-114	460
H. Allow All Inherited Plan and IRA Balances to be Rolled Over Within 60 Days.....	dma 12/31/15	----- <i>Negligible Revenue Effect</i> -----												
I. Expand the EITC for Workers without Qualifying Children [2].....	tyba 12/31/15	--	-68	-6,830	-6,984	-7,036	-7,114	-7,167	-7,271	-7,365	-7,498	-7,636	-28,031	-64,969
J. Simplify the Rules for Claiming the EITC for Workers Without Qualifying Children [2].....	tyba 12/31/15	--	-1	-82	-86	-87	-90	-93	-96	-99	-101	-104	-346	-838
K. Provide a Second-Earner Tax Credit [2].....	tyba 12/31/15	--	-2,517	-8,401	-8,449	-8,525	-8,590	-8,646	-8,697	-8,766	-8,811	-8,854	-36,483	-80,257
L. Extend Exclusion from Income for Cancellation of Certain Home Mortgage Debt (sunset 12/31/17).....	doioa 12/31/14	-454	-2,887	-1,991	-1,187	--	--	--	--	--	--	--	-6,519	-6,519
Total of Tax Reform for Families and Individuals.....		-454	-6,239	-25,311	-25,930	-24,975	-26,073	-26,818	-27,942	-28,347	-29,499	-30,737	-108,981	-252,322
XI. Reforms to Capital Gains Taxation, Upper-Income Tax Benefits, and the Taxation of Financial Institutions														
A. Reduce the Value of Certain Tax Expenditures.....	tyba 12/31/15	-576	14,405	48,017	46,764	49,755	52,924	56,238	59,476	62,603	65,922	69,545	211,290	525,075

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
B. Reform the Taxation of Capital Income.....	[13]	3,198	21,591	5,273	19,245	20,749	22,384	24,173	26,106	27,997	30,012	32,121	92,440	232,847
C. Implement the Buffett Rule by Imposing a New "Fair Share Tax".....	tyba 12/31/15	1,120	5,136	-5,546	4,503	4,785	5,092	5,409	5,785	6,045	6,275	6,546	15,090	45,151
D. Impose a Financial Fee.....	1/1/16	---	5,640	10,807	10,750	10,994	11,230	11,489	11,753	12,023	12,300	12,583	49,421	109,569
Total of Reforms to Capital Gains Taxation, Upper-Income Tax Benefits, and the Taxation of Financial Institutions.....		3,742	46,772	58,551	81,262	86,283	91,630	97,309	103,120	108,668	114,509	120,795	368,241	912,642
XII. Loophole Closers														
A. Require Current Inclusion in Income of Accrued Market Discount and Limit the Accrual Amount for Distressed Debt.....	dsaa 12/31/15	---	11	40	75	107	126	128	118	99	77	57	359	839
B. Require that the Cost Basis of Stock that is a Covered Security Must Be Determined Using an Average Cost Basis Method.....	psaa 12/31/15	-2	-10	-8	11	69	142	195	256	320	362	406	202	1,741
C. Tax Carried (Profits) Interests as Ordinary Income.....	tyea 12/31/15	60	1,322	2,056	2,091	1,853	1,736	1,564	1,432	1,296	1,175	1,059	9,118	15,644
D. Require Non-Spouse Beneficiaries of Deceased IRA Owners and Retirement Plan Participants to Take Inherited Distributions Over No More Than Five Years.....	[14]	---	[15]	40	150	278	462	869	943	906	867	824	929	5,339
E. Limit the Total Accrual of Tax-Favored Retirement Benefits [16].....	caaf tyba 12/31/15	---	296	401	412	423	433	445	459	472	486	500	1,965	4,327
F. Conform Self-Employment Contributions Act ("SECA") Taxes For Professional Service Businesses [17].....	tyba 12/31/15	---	1,511	2,805	3,073	3,260	3,387	3,538	3,697	3,858	4,034	4,219	14,036	33,382
G. Limit Roth Conversions to Pre-Tax Dollars.....	doa 12/31/15	---	[15]	3	7	12	18	24	30	36	43	50	41	224
H. Eliminate Deduction for Dividends on Stock of Publicly-Traded Corporations Held in Employee Stock Ownership Plans.....	dadpa DOE	173	649	969	1,003	1,038	1,075	1,112	1,151	1,191	1,233	1,276	4,907	10,870
I. Repeal Exclusion of Net Unrealized Appreciation in Employer Securities.....	dma 12/31/15	---	-16	-22	-16	-10	-4	2	11	20	29	42	-68	36
J. Disallow the Deduction for Charitable Contributions that are a Prerequisite for Purchasing Tickets to College Sporting Events.....	cmi tyba 12/31/15	---	43	218	227	236	245	255	265	276	287	299	970	2,352
Total of Loophole Closers.....		232	3,807	6,502	7,033	7,265	7,620	8,133	8,362	8,474	8,594	8,731	32,459	74,754
XIII. Incentives for Job Creation, Clean Energy, and Manufacturing														
A. Designate Promise Zones														
1. Employment credit provided to businesses that employ zone residents.....	tyba 12/31/15	---	-54	-211	-370	-524	-620	-621	-622	-624	-625	-627	-1,779	-4,898
2. Allow qualified property placed in service within the zone to be eligible for additional first-year depreciation of 100% of the adjusted basis of the property.....	tyba 12/31/15	---	-199	-507	-354	-255	-186	-132	-100	-83	-79	-84	-1,501	-1,979

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25	
B. Provide a Tax Credit for the Production of Advanced Technology Vehicles [18].....	vpisa 12/31/15 & before 1/1/23	---	-272	-394	-368	-415	-400	-342	-332	-189	-67	-31	-1,849	-2,810	
C. Provide a Tax Credit for Medium- and Heavy-Duty Alternative-Fuel Commercial Vehicles [19].....	vpisa 12/31/15 & before 1/1/22	---	-69	-112	-132	-159	-188	-209	-116	-63	-56	-51	-661	-1,157	
D. Modify and Extend the Tax Credit for the Construction of Energy-Efficient New Homes.....	haa 12/31/15 & before 1/1/26	-62	-119	-150	-178	-200	-218	-232	-238	-237	-233	-231	-926	-2,098	
E. Reduce Excise Taxes on Liquefied Natural Gas to Bring Into Parity with Diesel [20].....	fsoua 12/31/15	---	-2	-3	-3	-3	-3	-3	-3	-4	-4	-4	-15	-34	
F. Enhance and Modify the Conservation Easement Deduction															
1. Enhance and make permanent incentives for the donation of conservation easements [21].....	cma DOE	-13	-38	-45	-48	-50	-55	-66	-75	-84	-92	-100	-249	-666	
2. Pilot an allocable credit for conservation contributions and report to Congress.....	cma DOE	-5	-19	-25	-25	-25	-25	-25	-25	-25	-25	-25	-124	-249	
3. Eliminate the deduction for contributions of conservation easements on golf courses.....	cma DOE	10	24	24	25	25	26	26	27	28	28	29	134	272	
4. Restrict deductions and harmonize the rules for contributions of conservation easements for historic preservation.....	cma DOE	4	19	20	20	21	22	22	23	24	24	30	106	229	
Total of Incentives for Job Creation, Clean Energy, and Manufacturing.....		-67	-728	-1,403	-1,432	-1,584	-1,648	-1,581	-1,461	-1,258	-1,129	-1,095	-6,863	-13,390	
XIV. Modify Estate and Gift Tax Provisions		2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25	
A. Restore the Estate, Gift and Generation-Skipping Transfer ("GST") Tax Parameters in Effect in 2009 with Portability of Exemption Amount Between Spouses.....	dda & tma 12/31/15	---	1,576	7,028	8,978	12,085	15,506	16,769	17,723	18,639	19,566	20,549	45,174	138,421	
B. Require Consistency in Value for Transfer and Income Tax Purposes.....	ta tyoe	---	25	172	190	203	215	225	234	243	250	258	806	2,015	
C. Modify Transfer Tax Rules for Grantor Retained Annuity Trusts ("GRATs") and Other Grantor Trusts....	tca DOE	---	87	217	300	421	589	821	1,131	1,546	2,094	2,815	1,614	10,021	
D. Limit Duration of GST Tax Exemption.....	tca DOE	-----Negligible Revenue Effect-----													
E. Extend the Lien on Estate Tax Deferrals where Estate Consists Largely of Interest in Closely Held Business.....	[22]	---	3	4	6	8	8	8	9	10	11	13	29	80	
F. Modify GST Tax Treatment of Health and Education Exclusion Trusts.....	[23]	---	-10	-20	-20	-18	-16	-14	-12	-10	-8	-7	-83	-134	
G. Simplify Gift Tax Exclusion for Annual Gifts.....	gma tyoe	---	---	36	101	167	233	302	385	448	538	---	538	2,211	
H. Expand Applicability of Definition of Executor.....	DOE	-----Negligible Revenue Effect-----													
Total of Modify Estate and Gift Tax Provisions.....		---	1,681	7,437	9,555	12,866	16,535	18,111	19,470	20,876	22,451	23,628	48,078	152,614	

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
XV. Other Revenue Raisers														
A. Increase Oil Spill Liability Trust Fund Financing Rate (to 9 Cents Per Barrel Effective 2016 and 10 Cents Per Barrel Effective 2017) and Update the Law to Include Other Sources of Crudes [24].....	[25]	--	69	113	119	123	127	132	137	142	147	153	551	1,262
B. Reinstate Superfund Taxes														
1. Reinstate and Extend Superfund Excise Taxes.....	pa 12/31/15 & before 1/1/26	--	421	563	564	564	563	561	561	561	561	562	2,675	5,479
2. Reinstate Superfund Environmental Income Tax.....	tyba 12/31/15 & before 1/1/26	--	1,002	1,591	1,625	1,634	1,661	1,699	1,743	1,789	1,805	1,805	7,515	16,355
C. Increase Tobacco Taxes and Index for Inflation [2] [26].....														
	ara 12/31/15	--	6,395	8,241	8,005	8,222	8,485	8,726	8,998	9,225	9,422	9,605	39,349	85,325
D. Make the 0.2 Percent Unemployment Insurance ("UI") Surtax Permanent [27].....														
	wpo/a 1/1/16	--	1,070	1,438	1,452	1,464	1,477	1,490	1,504	1,517	1,530	1,544	6,901	14,486
E. Expand Federal Unemployment Tax Act ("FUTA") Base [27].....														
	DOE	--	--	13,506	9,176	2,910	-3,610	-3,030	-2,740	-2,962	-3,324	-2,678	21,982	7,248
F. Reform the UI extended benefits program [27].....														
	10/1/15	--	--	--	1	6	15	25	20	-3	-31	-48	22	-15
G. Modernize the UI program [27].....														
	10/1/15	--	--	--	--	-49	-155	-156	-121	-106	-202	-165	-204	-954
H. Levy a Fee on the Production of Hardrock Minerals to Restore Abandoned Mines [27].....														
	rma 12/31/16	--	--	111	148	148	148	148	148	148	148	148	555	1,295
I. Return Fees on the Production of Coal to Pre-2006 Levels to Restore Abandoned Mines (sunset 9/30/21) [27].....														
	Cma 9/30/15	--	--	36	37	38	39	38	38	--	--	--	150	226
Total of Other Revenue Raisers.....		--	8,957	25,599	21,127	15,060	8,750	9,633	10,288	10,311	10,056	10,926	79,496	130,707
XVI. Reduce the Tax Gap and Make Reforms														
A. Expand Information Reporting														
1. Improve information reporting for certain businesses and contractors:														
a. Require a certified taxpayer identification number ("TIN") from contractors and allow certain withholding.....	pmtca 12/31/15	--	7	53	37	39	41	43	46	48	51	53	178	419
b. Require information reporting for private separate accounts of life insurance companies.....	tyba 12/31/15	----- Negligible Revenue Effect -----												
2. Provide an exception to the limitation on disclosing tax return information to expand TIN matching beyond forms where payments are subject to backup withholding.....														
	DOE	----- Negligible Revenue Effect -----												
3. Provide for reciprocal reporting of information in connection with the implementation of the Foreign Account Tax Compliance Act ("FATCA").....														
	rtbfa 12/31/16	--	--	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	1
4. Improve mortgage interest deduction reporting.....														
	irdf cyba 12/31/15	19	131	154	160	172	180	200	215	236	260	283	816	2,010

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
5. Require Form W-2 reporting for employer contributions to defined contribution plans.....	irdf cyba 12/31/15	----- Negligible Revenue Effect -----												
B. Improve Compliance By Businesses														
1. Increase certainty with respect to worker classification [2] [28].....	generally DOE	---	158	551	993	1,183	1,254	1,277	1,306	1,335	1,359	1,378	4,140	10,796
2. Increase information sharing to administer excise taxes.....	DOE	---	3	5	7	9	11	14	17	19	21	22	35	126
3. Provide authority to readily share beneficial ownership of U.S. companies with law enforcement.....	DOE	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	1
C. Strengthen Tax Administration														
1. Impose liability on shareholders to collect unpaid income taxes of applicable corporations.....	[29]	59	222	217	141	147	153	160	166	173	180	187	938	1,804
2. Increase levy authority for payments to Medicare providers with delinquent tax debt.....	pma DOE	---	40	55	56	57	58	60	61	62	63	64	267	577
3. Implement a program integrity statutory cap adjustment for tax administration [27] [30].....	DOE	---	432	1,454	2,939	4,440	5,913	7,099	7,867	8,230	8,410	8,471	15,178	55,255
4. Streamline audit and adjustment procedures for large partnerships.....	[31]	---	---	87	634	790	824	886	966	1,050	1,092	1,118	2,335	7,447
5. Revise offer-in-compromise application rules.....	oicsa DOE	-5	-5	[32]	[32]	[32]	[32]	[32]	[32]	[32]	[32]	[32]	-10	-10
6. Expand Internal Revenue Service ("IRS") access to information in the National Directory of New Hires for tax administration purposes.....	DOE	----- No Revenue Effect -----												
7. Make repeated willful failure to file a tax return a felony.....	rrtbfa 12/31/15	----- Negligible Revenue Effect -----												
8. Facilitate tax compliance with local jurisdictions.....	Dma DOE	----- Negligible Revenue Effect -----												
9. Extend statute of limitations for assessment of overstated basis and State adjustments.....	rrtbfa 12/31/15	---	26	70	87	98	110	126	146	168	177	182	391	1,190
10. Improve investigative disclosure statute.....	Dma DOE	----- Negligible Revenue Effect -----												
11. Allow the IRS to absorb credit and debit card processing fees for certain tax payments.....	pma DOE	----- Negligible Revenue Effect -----												
12. Provide the IRS with Greater Flexibility to Address Correctable Errors [2].....	DOE	[15]	[15]	13	14	14	14	15	15	16	16	17	55	133
13. Enhance electronic filing of returns.....	tyba DOE & rrtbfa 12/31/15	----- Negligible Revenue Effect -----												
14. Improve the whistleblower program.....	DOE	----- Negligible Revenue Effect -----												
15. Index all civil penalties for inflation.....	DOE	---	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]	[15]
16. Extend IRS authority to require truncated Social Security Numbers on Form W-2.....	DOE	----- Negligible Revenue Effect -----												
17. Combat tax-related identity theft.....	DOE	----- Negligible Revenue Effect -----												
18. Allow States to send notices of intent to offset Federal tax refunds to collect State tax obligations by regular first-class mail instead of certified mail.....	DOE	----- Negligible Revenue Effect -----												
19. Rationalize tax return filing due dates so they are staggered [2].....	rrtbfa 12/31/15	---	-878	10	7	66	81	80	84	85	88	95	-715	-284

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
20. Increase oversight and due diligence of paid tax return preparers:														
a. Extend paid preparer EITC due diligence requirements to the child tax credit ("CTC") [2].....	rttba 12/31/15	---	---	5	5	5	5	5	5	5	5	5	19	43
b. Explicitly provide that the Department of the Treasury and the IRS have authority to regulate all paid return preparers [2].....	DOE	[15]	5	11	12	13	14	15	15	16	17	18	54	135
c. Increase the penalty applicable to paid tax preparers who engage in willful or reckless conduct.....	rttbfa 12/31/15	---	[15]	[15]	1	1	1	1	1	1	1	1	3	9
21. Enhance administrability of the appraiser penalty.....	rttbfa 12/31/15	----- Negligible Revenue Effect -----												
22. Enhance UI program integrity [2] [27] [30].....	10/1/15	---	31	61	60	56	52	50	50	50	52	54	260	516
Total of Reduce the Tax Gap and Make Reforms.....		73	172	2,746	5,153	7,090	8,711	10,031	10,960	11,494	11,792	11,948	23,944	80,168
XVII. Simplify the Tax System														
A. Modify Adoption Credit to Allow Tribal Determination of Special Needs.....	tyba 12/31/15	---	[8]	-1	-1	-1	-1	-1	-1	-1	-1	-1	-3	-7
B. Repeal Non-Qualified Preferred Stock ("NQPS") Designation.....	sia 12/31/15	---	5	11	12	12	13	13	14	15	16	17	53	128
C. Repeal Preferential Dividend Rule for Publicly Traded and Publicly Offered REITs.....	dmi tyba DOE	----- Negligible Revenue Effect -----												
D. Reform Excise Tax Based on Investment Income of Private Foundations.....	tyba DOE	---	-9	-13	-13	-14	-15	-15	-16	-16	-17	-18	-63	-146
E. Remove Bonding Requirements for Certain Taxpayers Subject to Federal Excise Taxes on Distilled Spirits, Wine, and Beer.....	90da DOE	----- Negligible Revenue Effect -----												
F. Simplify Arbitrage Investment Restrictions.....	bia DOE	[8]	-3	-12	-24	-35	-46	-58	-71	-83	-96	-108	-120	-536
G. Simplify Single-Family Housing Mortgage Bond Targeting Requirements.....	bia DOE	[8]	-1	-5	-11	-19	-28	-37	-48	-60	-74	-90	-64	-373
H. Streamline Private Business Limits on Governmental Bonds.....	bia DOE	[8]	[8]	-1	-3	-5	-7	-9	-11	-13	-15	-17	-16	-81
I. Repeal Technical Terminations of Partnerships.....	ta 12/31/15	---	4	12	19	22	23	24	25	26	27	23	80	205
J. Repeal Anti-Churning Rules of Code Section 197.....	aa 12/31/15	---	-22	-76	-152	-250	-370	-435	-435	-435	-435	-435	-871	-3,047
K. Repeal Special Estimated Tax Payment Provision for Certain Insurance Companies.....	tyba 12/31/15	----- Negligible Revenue Effect -----												
L. Repeal the Telephone Excise Tax.....	[33]	---	-368	-417	-378	-342	-309	-279	-253	-229	-207	-187	-1,814	-2,969
M. Increase the Standard Mileage Rate for Automobile Use by Volunteers.....	tyba 12/31/15	---	-13	-52	-54	-56	-57	-59	-61	-63	-66	-68	-231	-549
N. Consolidate Contribution Limitations for Charitable Deductions and Extend the Carryforward Period for Excess Charitable Contribution Deduction Amounts.....	tyba 12/31/15	---	-15	-239	-260	-278	-289	-498	-683	-838	-987	-1,124	-1,082	-5,212
O. Exclude from Gross Income Subsidies from Public Utilities for Purchase of Water Runoff Management.....	spfvacswma 12/31/15	----- Negligible Revenue Effect -----												

Provision	Effective	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
P. Provide Relief for Certain Accidental Dual Citizens.....	1/1/16	-4	-28	-32	-33	-32	-18	-20	-23	-27	-30	-32	-147	-279
Total of Simplify the Tax System.....		-4	-449	-825	-898	-998	-1,104	-1,375	-1,564	-1,725	-1,885	-2,040	-4,279	-12,866
XVIII. User Fees														
A. Reform Inland Waterways Funding [27].....	vuicwtba 9/30/15	---	63	84	84	84	84	84	84	84	83	83	399	817
B. Reauthorize Special Assessment On Domestic Nuclear Utilities [27].....	10/1/15	---	152	154	158	162	165	169	173	177	181	185	791	1,676
Total of User Fees.....		---	215	238	242	246	249	253	257	261	264	268	1,190	2,493
XIX. Trade Initiatives														
A. Extend the Generalized System of Preferences (sunset 12/31/16) [27].....	10/1/15	---	-1,149	-104	---	---	---	---	---	---	---	---	-1,253	-1,253
B. Extend African Growth and Opportunity Act (sunset 9/30/30) [27].....	10/1/15	---	-88	-120	-133	-147	-162	-178	-195	-215	-235	-256	-650	-1,729
Total of Trade Initiatives.....		---	-1,237	-224	-133	-147	-162	-178	-195	-215	-235	-256	-1,903	-2,982
XX. Other Initiatives														
A. Allow Offset of Federal Income Tax Refunds to Collect Delinquent State Income Taxes for Out-of-State Residents.....	DOE	----- Negligible Revenue Effect -----												
B. Authorize the Limited Sharing of Business Tax Return Information to Improve the Accuracy of Important Measures of the Economy.....	DOE	----- No Revenue Effect -----												
C. Eliminate Certain Reviews Conducted by the U.S. Treasury Inspector General for Tax Administration ("TIGTA").....	tyba 12/31/15	----- No Revenue Effect -----												
D. Modify Indexing to Prevent Deflationary Adjustments.....	DOE	----- No Revenue Effect -----												
E. Enact Comprehensive Immigration Reform.....	DOE	----- JCT's Estimate of the Revenue Effects of Immigration Reform is Included in the CBO Immigration Cost Estimate -----												
Total of Other Initiatives.....		----- Negligible Revenue Effect -----												
NET TOTAL		-3,783	100,428	141,857	162,842	143,180	138,964	95,037	101,815	105,140	108,879	115,359	683,497	1,209,737

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be July 1, 2015.

[Legend and Footnotes for JCX-50-15 appear on the following pages]

Legend for JCX-50-15:

Legend for "Effective" column:

aa = acquisitions after	doUSrpioa = dispositions of U.S. real property interests occurring after	qwpdf12mpbo = qualified wages paid during the 12-month period beginning on
amo/a = allocations made on or after	dpoia = damages paid or incurred after	racia = research agreements entered into after
ami = allocations made in	dsaa = debt securities acquired after	rma = rock mined after
ara = articles removed after	edoa = eligible distributions occurring after	rtbfa = returns required to be filed after
Ara = amounts realized after	epoia = expenses paid or incurred after	sia = stock issued after
aspioiUSA = all spirits produced in or imported into the United States after	Epoia = expenditures paid or incurred after	soea = sales or exchanges after
bia = bonds issued after	fsoua = fuel sold or used after	spfwcaswma = subsidies provided for water conservation and storm water management after
bii = bonds issued in	fyba = first taxable year beginning after	ta = transfers after
bio/a = bonds issued on or after	gma = gifts made after	tca = trusts created after
bis = bonds issued starting	irdf = information returns due for	Tca = transactions completed after
caaf = contributions and accruals for	lkeca = like-kind exchanges completed after	tma = transfers made after
cma = contributions made after	oicsa = offers-in-compromise submitted after	toa = transactions occurring after
Cma = coal mined after	pa = periods after	tyba = taxable years beginning after
cyba = calendar years beginning after	pii = policies issued in	tyea = taxable years ending after
cybo/a = calendar years beginning on or after	pma = payments made after	tyoe = the year of enactment
dadpa = dividends and distributions paid after	pmtea = payments made to contractors after	vpisa = vehicles placed in service after
dceia = derivative contracts entered into after	pocia = production of costs incurred after	vuicwtha = vessels used in commercial waterway transportation beginning after
dda = decedents dying after	powcba = property on which construction begins after	wpo/a = wages paid on or after
dma = distributions made after	ppisa = property placed in service after	wptqei = wages paid to qualified employees in
Dma = disclosures made after	psaa = portfolio stock acquired after	wptqiwbftea = wages paid to qualified individuals who begin work for the employer after
dmi = distributions made in	ptybo/a = partnership's taxable year beginning on or after	90da = 90 days after
doa = distributions occurring after	pyba = plan years beginning after	
DOE = date of enactment	qjai = qualified investments approved in	
doioa = discharge of indebtedness occurring after	qppisi = qualifying property placed in service in	
dola = discharges of loans after	qbsaa = qualified small business stock acquired after	

[Footnotes for JCX-50-15 appear on the following pages]

Footnotes for JCX-50-15:

[1] To the extent the proposals are not fully specified, estimates will be updated as new information becomes available and policy intent is clarified.

[2] Estimate includes the following outlay effects [34]:

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
Reduce the earnings threshold for the refundable portion of the child tax credit to \$3,000.....	---	---	---	---	12,373	12,455	12,452	12,534	12,597	12,694	12,733	24,827	87,839
EITC modification and simplification (\$5,000).....	---	---	---	---	1,342	1,334	1,325	1,318	1,313	1,317	1,316	2,676	9,265
Extend EITC for larger families.....	---	---	---	---	2,433	2,491	2,557	2,610	2,673	2,757	2,827	4,924	18,348
American opportunity tax credit.....	---	---	---	---	6,279	6,275	6,252	6,278	6,255	6,262	6,280	12,554	43,881
Expand and simplify the tax credit provided to qualified small employers for non-elective contributions to employee health insurance.....	8	13	13	16	11	11	19	21	22	23	24	72	181
Modify and permanently extend renewable electricity production tax credit and investment tax credit.....	---	---	25	269	502	586	620	584	594	592	631	1,384	4,405
Provide a carbon dioxide investment and sequestration tax credit.....	---	---	---	176	404	637	914	1,147	995	826	817	1,217	5,915
Provide America Fast Forward Bonds and expand eligible uses.....	---	91	760	1,978	3,300	4,695	6,185	7,765	9,391	11,065	12,787	10,824	58,017
Reform child care tax incentives.....	---	828	876	887	899	908	928	964	980	983	983	3,490	8,253
Expand and modify the AOTC and repeal Lifetime Learning Credits.....	---	---	3,742	3,504	3,186	3,376	3,498	3,868	3,518	3,614	3,768	13,808	32,074
Make Pell grants excludable from income.....	---	---	186	476	461	450	456	454	457	458	451	1,573	3,849
Modify reporting of tuition expenses and scholarships on Form 1098-T.....	---	---	-14	-14	-15	-16	-17	-18	-19	-20	-21	-61	-156
Repeal the student loan interest deduction and provide exclusion for certain debt relief and scholarships.....	---	---	---	---	---	---	-15	-30	-46	-64	-82	---	-237
Provide for automatic enrollment in IRAs, including a small employer tax credit, and double the tax credit for small employer plan start-up costs and provide an additional tax credit for small employer plans newly offering auto-enrollment.....	---	---	---	393	371	387	401	414	429	448	462	1,151	3,305
Require retirement plans to allow long-term part-time workers to participate..	---	---	-8	-11	-11	-12	-14	-15	-15	-17	-18	-41	-120
Expand the EITC for workers without qualifying children.....	---	---	5,384	5,511	5,514	5,544	5,569	5,627	5,687	5,758	5,847	21,953	50,441
Simplify the rules for claiming the EITC for workers without qualifying children.....	---	---	58	61	62	64	66	68	70	72	74	246	596
Provide a second-earner tax credit.....	---	---	728	744	744	725	717	702	694	685	672	2,941	6,411
Increase tobacco taxes and index for inflation [27].....	---	-16	-76	-122	-166	-213	-255	-299	-326	-335	-335	-592	-2,143
Increase certainty with respect to worker classification.....	---	34	59	88	70	83	83	83	82	82	82	334	746
Provide the IRS with greater flexibility to address correctable errors.....	[35]	[35]	-3	-3	-3	-4	-4	-4	-4	-4	-4	-14	-33
Rationalize tax return filing due dates so they are staggered.....	---	-1	-4	-7	-10	-12	-15	-17	-19	-20	-22	-34	-126
Extend paid preparer EITC due diligence requirements to the CTC.....	---	---	-4	-4	-4	-4	-4	-4	-4	-5	-4	-18	-40
Explicitly provide that the Department of Treasury and IRS have authority to regulate all paid return preparers.....	[35]	-2	-4	-4	-4	-5	-5	-5	-5	-6	-6	-18	-45
Enhance UI program integrity [27].....	---	-31	-63	-70	-80	-90	-100	-111	-121	-131	-141	-334	-938
Total Outlay Effects	8	88	11,607	13,857	37,646	39,656	41,594	43,898	45,183	47,031	49,121	102,862	329,687

[3] Effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end.

[4] Effective on the date of enactment and would apply to earnings accumulated for taxable years beginning before January 1, 2016.

[5] Effective with respect to PAB volume cap to be received in, and additional LJHTC allocation authority received for, calendar years beginning after the date of enactment; and effective for projects that are allocated volume cap after the date of enactment.

[Footnotes for JCX-50-15 continue on the following pages]

Footnotes for JCX-50-15 continued:

[6] Effective for elections under section 42(g)(1) that are made after the date of enactment.

[7] The proposed requirements for Long-Term Use Agreements would be effective for Agreements that are either first executed, or subsequently modified, 30 days or more after enactment. The proposed clarification of the general public use requirement would be effective for taxable years ending after the date of enactment.

[8] Loss of less than \$500,000.

[9] Effective for sales or assignment of interests in life insurance policies and payments of death benefits in taxable years beginning after December 31, 2015.

[10] Effective for contracts issued after December 31, 2015, in taxable years ending after that date.

[11] Estimate includes the following effects:	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
Total Revenue Effects.....	---	552	983	1,084	1,172	1,240	1,300	1,365	1,434	1,505	1,540	5,031	12,176
On-budget effects.....	---	582	1,058	1,183	1,281	1,356	1,423	1,494	1,569	1,647	1,687	5,459	13,280
Off-budget effects.....	---	-30	-75	-99	-109	-116	-123	-129	-135	-142	-147	-428	-1,104

[12] Generally effective for taxpayers attaining age 70½ after December 31, 2015, and for taxpayers who die on or after December 31, 2015, before attaining age 70½.

[13] Effective for capital gains realized and qualified dividends received in taxable years beginning after December 31, 2015, and for gains on gifts made and of decedents dying after December 31, 2015.

[14] Generally effective for distributions with respect to plan participants or IRA owners who die after December 31, 2015.

[15] Gain of less than \$500,000.

[16] Estimate includes the following effects:	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
Total Revenue Effects.....	---	296	401	412	423	433	445	459	472	486	500	1,965	4,327
On-budget effects.....	---	290	393	403	414	424	436	449	462	476	490	1,924	4,237
Off-budget effects.....	---	6	8	9	9	9	9	10	10	10	10	41	90

[17] Estimate includes the following effects:

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
Total Revenue Effects.....	---	1,511	2,804	3,073	3,261	3,387	3,538	3,697	3,859	4,034	4,219	14,036	33,382
On-budget effects.....	---	758	1,485	1,632	1,732	1,798	1,878	1,969	2,070	2,175	2,284	7,405	17,781
Off-budget effects.....	---	753	1,319	1,441	1,529	1,589	1,660	1,728	1,789	1,859	1,935	6,631	15,601

[18] The credit would be 75 percent of the otherwise allowable amount for vehicles placed in service in 2020, 50 percent of such amount for vehicles placed in service in 2021, and 25 percent of such amount for vehicles placed in service in 2022.

[19] For vehicles placed in service in calendar year 2021, the credit would be limited to 50 percent of the otherwise allowable amount.

[20] The proposal would lower the 24.3 cents per gallon excise tax on LNG to 14.1 cents per gallon beginning after December 31, 2015.

[21] Estimate includes interaction with the proposal to create an allocable credit for conservation contributions.

[22] The proposal would be effective for the estates of all decedents dying on or after the effective date, as well as for all estates of decedents dying before the date of enactment as to which the section 6324(a)(1) lien has not expired on the effective date.

[23] Effective for trusts created after the introduction of the bill proposing this change, and to transfers after that date made to pre-existing trusts.

[24] The revenue estimate assumes a permanent extension of the financing rate at the rate of 10 cents per barrel effective for production after December 31, 2017.

[25] Effective at the applicable rate on such crudes received at a U.S. refinery, entered into the United States, or used or exported as described above after December 31, 2015.

[26] Estimate provided in consultation with the Congressional Budget Office and includes both outlay effects (see footnote 2 above) and indirect effects (following) resulting from the

health benefits of a reduction in tobacco consumption:	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
On-budget effects.....	---	10	28	37	46	57	71	86	104	123	146	178	707
Off-budget effects.....	---	4	10	14	17	22	27	32	39	46	54	68	266

[27] Estimate provided by the Congressional Budget Office.

[28] Estimate includes the following effects:

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2015-20	2015-25
Total Revenue Effects.....	---	158	551	993	1,183	1,254	1,277	1,306	1,335	1,359	1,378	4,140	10,796
On-budget effects.....	---	-8	-13	-14	-35	-64	-70	-76	-81	-88	-96	-133	-545
Off-budget effects.....	---	166	564	1,007	1,218	1,318	1,348	1,382	1,417	1,447	1,474	4,273	11,341

[29] Effective for sales of controlling interests in the stock of applicable C corporations occurring on or after April 10, 2013.

[Footnotes for JCX-50-15 continue on the following page]

EXHIBIT D

1969 Tax Reform Study v. 2016 Deemed Realization Proposal

I. General Principles

a. Current Unrealized Appreciation Subject to Tax?

- i. 1969 Tax Reform Study – deemed realization would only apply to Future Appreciation
 1. Only appreciation occurring after the date of enactment would be subject to tax (p. 335).
 2. “The transition to the new system will be smoothed for those who are now holding appreciated assets in anticipation of tax-free transfers at death, by a provision that only appreciation occurring after the date of enactment would be subject to the tax at death.” (p. 335)

- ii. 2016 Deemed Realization Proposal would apply to all gains.

1. See footnote 389 of Sept. 2015 Joint Committee Report which states:
 - a. “One could argue that the absence of a transition rule raises a question of fairness for taxpayers who have made decisions based on present law to retain appreciated assets in anticipation of death. On the other hand, taxing only appreciation that occurs after the effective date could be administratively complex, requiring a valuation of all property not only at the time of sale, but also as of the effective date of the proposal.”

b. Parallel Provisions – Deemed Realization and Transfer Tax Rules

- i. 1969 Tax Reform Study: Creates Parallel Provisions

1. Comments in the 1969 Tax Reform Study:
 - a. “Present rules for payment of taxes due at death for those estates that have liquidity problems will be liberalized, and the new rules will apply to capital gains taxes as well as transfer taxes.” (p. 335)
 - b. “As part of the unified transfer tax proposal a 100-percent marital deduction will apply to transfers between spouses by gift or death. The marital exclusion under the gain proposal will correspond to the unified transfer tax provision. No gain will be recognized on the appreciation in value of property passing to the surviving spouse at death which qualifies for the transfer tax marital exclusion.” (emphasis added) (p. 337)
 - c. “A gift will not be treated as “completed,” that is, subject to tax, unless the transfer is of a type of which the transfer tax is imposed under the unified transfer tax proposal.” (p. 339).
 - d. “A marital exclusion will cover property transferred to a surviving spouse and will be analogous to the marital deduction for estate tax purposes.” (p. 342)
 - e. “The marital exclusion under the income tax proposal will correspond to the unified transfer tax provisions so that on transfers that qualify for the transfer tax marital exclusion no

gain will be recognized on the appreciation in value of property passing to the surviving spouse at death.” (p. 343)

II. Final Income Tax Return

- a. 1969 Tax Reform Study: Decedent’s final income tax return would be due at the same time as the estate tax return (pp. 335 & 340).
- b. 2016 Deemed Realization Proposal: Deemed Gain Reported on Decedent’s Final Income Tax Return (no indication that date would be any different than current law) or Separate Capital Gains Return

III. Alternate Valuation Date

- a. 1969 Tax Reform Study: Fair market value determined on date of death or alternate valuation date (pp. 335 & 340).
- b. 2016 Deemed Realization Proposal: Silent

IV. Capital Gain

- a. 1969 Tax Reform Study: Long-term capital gain would be available regardless of the length of time the decedent held the property (pp. 336 & 340).
- b. No special rule would apply on gifts, so the actual holding period of the donor would be used on gifts. (p. 349).
- c. 2016 Deemed Realization Proposal: Silent

V. Losses

- a. 1969 Tax Reform Study
 - i. Capital Losses recognized as well as deemed gains (pp. 336 & 341)
 - ii. Capital losses and capital loss carryforwards will offset capital gains plus ordinary income subject to limit (pp. 336 & 341)
 - iii. If any excess capital losses, excess can be carryback for 3 prior taxable years (pp. 336 & 341).
 - iv. If any excess after prior application, then offset ordinary income earned in final year and then for 3 prior years (pp. 336 & 341), but see special limitation set forth on p. 341
 - v. “Losses due to depreciation in value of personal and household items will be disallowed following the usual rules relating to losses of a personal nature.” (p. 337 & 342)
 - vi. “Losses will be allowed on lifetime gifts under the same rules as apply at death. However, no losses will be allowed on transfers between related parties.” (p. 339 & 349)

- b. 2016 Deemed Realization Proposal: Silent

VI. Income tax on deemed realization a debt of estate

- a. 1969 Tax Reform Study: Considered a debt of the estate for deductibility on estate tax return (p. 336 & 341).
- b. 2016 Deemed Realization Proposal: Considered a debt of the estate for deductibility on estate tax return.

VII. Basic Exclusion

- a. 1969 Tax Reform Study
 - i. \$60,000 basic exclusion (p. 336 & 342)

- ii. Every taxpayer would be deemed to have a minimum basis in property at death of \$60,000 or fair market value, whichever is less. (p. 336 & 342).
 - iii. Note, \$60,000 exclusion equaled the exclusion for estate tax purposes. In other words, a \$60,000 estate would not be subject to estate taxes or the deemed realization.
 - iv. "In order that small estates will generally be exempt from income tax as well as estate tax, gain will only be taxed at death to the extent the value of the property exceeded the greater of the decedent's aggregate basis or \$60,000." (p. 341)
- b. 2016 Deemed Realization Proposal
- i. The 2015 Deemed Realization Proposal provides a \$100,000 per-person exclusion of capital gains, indexed for inflation, with portability of any unused amount to a surviving spouse.

VIII. Personal and Household Effects

a. 1969 Tax Reform Study

- i. Exempt all gain on ordinary personal and household items of a value of less than \$1,000 (p. 337 & 342)
 - 1. Includes clothing, drapery, carpeting, furniture, appliances, cars, jewelry, furs, works of art, "and so forth." (p. 342)
 - 2. "For purposes of this rule [\$1,000 rule], assets that constitute a set or collection, such as stamps, guns, coins, or works of art, will be treated as a single asset. When it is determined that a set or collection exceeds \$1,000 in value then each item will be valued individually; gain will be recognized on individual items in the set that have appreciated in value and losses due to depreciation in value will be disallowed under usual rules relating to losses of a personal nature." (p. 342)
- ii. Losses on personal and household items will not be allowed (p. 337)
- iii. Basis to transferee of personal and household effects will be fair market value at death (p. 337)
- iv. Basis to the decedent's transferee of the personal and household effects passing under this exception will be their fair market value at the decedent's death. (p. 337 & 342)

b. 2016 Deemed Realization Proposal

- i. Exempts from taxation the gain on tangible personal property such as household furnishings and personal effects (excluding collectibles).
 - 1. Does not provide examples: Cars?
 - 2. Does collectibles include amateur stamp collections?

IX. Residence

- a. 1969 Tax Reform Study: no exclusion for personal residence -deemed unnecessary (p. 342)
- b. 2016 Deemed Realization Proposal:
 - i. \$250,000 per-person exclusion for capital gain on a principal residence would apply to all residences and would be portable

X. Marital Exclusion

- a. 1969 Tax Reform Study:
 - i. No gain will be recognized on the appreciation in value of property passing to the surviving spouse (p. 337)
 - ii. Where spouse receives all decedent's property, property passing to spouse will receive a carry-over basis (p. 337)
 - iii. Where spouse receives less than all the decedent's property, special basis allocation required (p. 337)
 - iv. "As part of the unified transfer tax proposal a 100-percent marital deduction will apply to transfers between spouses by gift or death. The marital exclusion under the gain proposal will correspond to the unified transfer tax provision. No gain will be recognized on the appreciation in value of property passing to the surviving spouse at death which qualifies for the transfer tax marital exclusion." (emphasis added) (p. 337)
 - v. "A marital exclusion will cover property transferred to a surviving spouse and will be analogous to the marital deduction for estate tax purposes." (p. 342)
 - vi. "The marital exclusion under the income tax proposal will correspond to the unified transfer tax provisions so that on transfers that qualify for the transfer tax marital exclusion no gain will be recognized on the appreciation in value of property passing to the surviving spouse at death." (p. 343)
 - vii. See p. 343 for tax apportionment (and note infra).
 - viii. Election: "In the case of some form of outright interest passing to a transferee spouse, an option will be made available to have taxed any portion of the property passing under the marital deduction at the time of the transfer. A step up in basis would, of course, accompany this event. The election to be taxed will be exercisable by the transferor and, in the case of a transfer at death, if the transferor makes no election than by the transferee spouse." (p. 343).
- b. 2016 Deemed Realization Proposal:
 - i. Gifts or bequests to spouse would not be subject to deemed realization and spouse would receive a carry-over basis.
 - ii. Silent as to whether exclusion from gain would apply to transfers to marital trusts.

XI. Charitable Exclusion

- a. 1969 Tax Reform Study:
 - i. No tax on appreciation in property given outright to charity (p. 337)
 - ii. "Where a transfer creates a split interest (e.g., a trust to pay the income to the transferor's son for life, with the remainder to the x charity or vice versa), the same rules will apply as to gifts or bequests to charity" (p. 337)
 - iii. "Where a transfer creates a split interests (that is, a trust to pay the income to the transferor's son for life, with the remainder to the X charity or vice versa), the portion going to the charity will qualify for the exemption... [continues by setting forth the terms required of a CRUT, CRAT, CLAT, or CLUT]." (p. 344)
 - 1. "For example, if a donor gives a life interest in certain property to A with a remainder to X charity, and the life interest is determined to be equal to 40 percent of the value of the property and the remainder 60

percent, then 40 percent of the gain from the appreciation in the property would be subject to income tax and 60 percent would be exempt under the charitable exception. (The same procedure will be followed with respect to bequests of present and future interests in property transferred at death.)” (p. 348 – 349).

- b. 2016 Deemed Realization Proposal
 - i. No deemed realization on property passing to charity.
 - ii. Silent as to whether, and if so, how, the exclusion would apply to split-interest trusts.

XII. Allocation of Basis

- a. 1969 Tax Reform Study: See detailed rules that apply if spouse or charity receive less than the entire estate (p. 338 & 345-346)
- b. 2016 Deemed Realization Proposal: Silent

XIII. Liquidity Issues

- a. 1969 Tax Reform Study
 - i. Would liberalize present rules for payment of taxes due for those estates with liquidity problems with the new rules applying to capital gains taxes as well as transfer taxes (p. 335)
 - ii. Reference is made to 6161 and 6166 at p. 347
 - iii. “The proposals broadening the liquidity provisions governing payment of transfer taxes at death will also cover the income taxes attributable to the gains taxed at death.” (p. 347)
 - iv. No relief for liquidity issues on gifts, see p. 349.
- b. 2016 Deemed Realization Proposal
 - i. Present-law exclusion in IRC Sec. 1202 for capital gain on certain small business stock would apply to exclude deemed realization of gain from such stock.
 - ii. Payment of tax on the gain arising from a gift or bequest of an interest in certain small family-owned and family-operated businesses would be deferred until the business is sold or ceases to be family-owned and operated.
 - iii. Provides for a 15-year fixed-rate payment plan for the tax on appreciated assets transferred at death, other than liquid assets such as publicly traded financial assets and other than businesses for which the deferral election is made.
 - iv. Sec. 6161 Hardship: Silent

XIV. Ordinary Income

- a. 1969 Tax Reform Study:
 - i. Would apply to IRD items so that all IRD items would be taxed in decedent’s final income tax return. (p. 338 & 347)
 - ii. To avoid bunching problems, averaging rules would apply (p. 339 & 347)
- b. 2016 Deemed Realization Proposal
 - i. Presumably would only apply to capital gains.

XV. Gifts

- a. 1969 Tax Reform Study:
 - i. Applies to gifts, marital and charity exclusions would apply (p. 339)

- ii. “A gift will not be treated as “completed,” that is, subject to tax, unless the transfer is of a type of which the transfer tax is imposed under the unified transfer tax proposal.” (p. 339). See also p. 348.
- iii. Would not apply to ordinary personal household effects (p. 339)

b. 2016 Deemed Realization Proposal

- i. Applies to gifts, marital and charitable deduction would apply
- ii. Carry-over basis would occur as to gifts to spouse and charity.

XVI. Dynasty Trusts

a. 1969 Tax Reform Study:

- i. Would impose a deemed realization upon taxable termination for trusts with related parties and every 20 years for trusts with beneficiaries unrelated to grantor (p. 339-340 & 349-351)

b. 2016 Deemed Realization Proposal: Silent

XVII. General Power of Appointment and Other Non-Probate Assets Included in Gross Estate

a. 1969 Tax Reform Study:

- i. “Under the proposal the gain on assets held at death, including assets over which the decedent has a general power of appointment will be subject to income taxation at that time.” (p. 340).
- ii. Silent as to other non-probate property

b. 2016 Deemed Realization Proposal: Silent

XVIII. Tax Apportionment

a. 1969 Tax Reform Study:

- i. “To protect the transferee spouse from liability from tax on property not fully subject to his or her control or power of disposition, the tax imposed on the gain at termination of one of the kinds of limited interests that is sufficient to qualify property for the marital exemption will be collectible only out of such property.” (p. 343)

b. 2016 Deemed Realization Proposal: Silent

EXHIBIT E

EXHIBIT E

Application of the Deemed Realization Tax When Part, But Not All, of an Estate or Trust Passes to a Surviving Spouse or when Community Property is Held in a Joint Administrative Trust and the Trust Estate Can Be Distributed Non-Pro Rata by the Trustee

Congress could address how the Deemed Realization Tax should apply when part, but not all, of an estate passes to a surviving spouse or when community property in a joint administrative trust can be distributed non-pro rata by the trustee as follows:

Step 1. The decedent's executor should first determine the decedent's potential income tax liability for the final year by deeming the realization of gains and losses with respect to all of the decedent's property except for property passing to charity, which would take a carryover basis unless otherwise elected by the executor. If the decedent has a surviving spouse but the decedent's executor elects to treat all property passing to the surviving spouse as having been sold on the date of the decedent's death, this will be the ultimate income tax liability for the final year.

Step 2. If the decedent has a surviving spouse and the decedent's executor does not elect to treat any property passing to the surviving spouse as having been sold on the date of the decedent's death, the decedent's ultimate income tax liability for the final year should be re-determined by eliminating the gains and losses with respect to the property passing to the surviving spouse. However, unless otherwise provided in the decedent's will, in order to treat the surviving spouse fairly, the executor should be required to make an equitable adjustment by distributing to the surviving spouse an amount equal to the difference between the liabilities determined under Steps 1 and 2.

With respect to community property held in a joint administrative trust (*i.e.*, a joint revocable trust following the death of one of the spouses) that can be distributed pro rata or

otherwise between the surviving spouse and the deceased spouse, the deceased spouse's share of the trust estate should be charged with the portion of the income tax liability on the final income tax return attributable to the deceased spouse's share of the taxable income for the final year, including the tax liability attributable to the gains and losses deemed to have been realized with respect to the share of the community property distributed to the deceased spouse. The surviving spouse's share of the trust estate should be charged with the portion of the income tax liability on the final income tax return attributable to the surviving spouse's share of the taxable income for the final year, and the surviving spouse should take a carryover basis with respect to the share of the community property distributed to the surviving spouse. In order to treat the surviving spouse fairly, however, unless otherwise provided in the trust instrument, the trustee should be required to make an equitable adjustment in favor of the surviving spouse.

For example, assume that Husband dies survived by Wife and Issue; and after paying debts and expenses of administration, Husband's adjusted gross estate consists of the following assets, before reduction by Husband's additional income tax liability attributable to the deemed sales of the property included in the gross estate on the date of his death:

<u>Asset</u>	<u>Basis On Date of Death</u>	<u>Fair Market Value on Date of Death</u>
PR	\$ 400,000	\$ 1,200,000
VH	500,000	800,000
MF	600,000	500,000
Cash	500,000	500,000
Totals	<u>\$ 2,000,000</u>	<u>\$ 3,000,000</u>

(a) Special Distributions to Wife and Issue and Residue Distributed to a Bypass Trust Benefitting Wife and Issue.

Assume that Asset PR (Husband's principal residence) is distributable to Wife, Asset VH (Husband's vacation home) is distributable to Issue, and the residue of the estate, consisting of Asset MF (Husband's mutual fund shares) and Husband's Cash, are distributable to a bypass trust (the "Trust"), of which Wife and Issue are current beneficiaries. If Husband's executor elects to deem Asset PR as being sold on the date of Husband's death, the spouses' combined \$500,000 principal residence exclusion under IRC Section 121 would reduce the gain realized with respect to that deemed sale; otherwise, Husband's \$250,000 IRC Section 121 exclusion and holding period should be carried over to Wife along with his \$400,000 basis with respect to Asset PR.

Step 1

Combined FMV of Assets PR, VH and MF on Date of Death	\$2,500,000
Combined Basis of Assets PR, VH and MF on Date of Death	-1,500,000
IRC Section 121 PR exclusion	-500,000
General Exclusion	<u>-100,000</u>
Taxable Gain	\$400,000

If Husband's executor elects to deem Asset PR (the only asset passing to Wife) as having been sold on the date of Husband's death, the additional income tax liability with respect to the deemed sales of Assets PR, VH and MF will simply be payable out of the residue of the estate distributable to the Trust. If the combined Federal and state income tax rate is 25%, then the ultimate income tax liability with respect to the deemed sales will be \$100,000 (25% of \$400,000).

Step 2

If Husband's executor does not elect to deem Asset PR as having been sold on the date of Husband's death, Husband's ultimate income tax liability for his final year should be determined by eliminating the gain with respect to Asset PR, as follows:

Combined FMV of Assets VH and MF on Date of Death	\$1,300,000
Combined Basis of Assets VH and MF on Date of Death	-1,100,000
General Exclusion	<u>-100,000</u>
Taxable Gain	\$100,000

Husband's ultimate tax liability for his final year would then be only \$25,000 (25% of \$100,000).

Unless otherwise provided in Husband's will, if Husband's executor does not elect to deem Asset PR as having been sold on the date of Husband's death, in order to treat Wife fairly Husband's executor should be required to distribute \$75,000 to Wife, *i.e.*, the amount equal to the deference between the liabilities determined under Steps 1 and 2 (\$100,000 minus \$25,000); and Husband's \$250,000 IRC Section 121 exclusion and holding period should be carried over to Wife, along with his \$400,000 basis with respect to Asset PR. If Wife then sold Asset PR for \$1,200,000, its fair market value on the date of Husband's death, her taxable gain would be determined as follows:

Sales Proceeds of Asset PR	\$1,200,000
Basis of Asset PR	-400,000
IRC Section 121 PR Exclusion	<u>-500,000</u>
Taxable Gain	\$300,000

Wife's income tax liability with respect to that taxable gain, again assuming a combined Federal and state income tax rate of 25%, would be \$75,000 (25% of \$300,000), which is equal to the income tax savings resulting from no deemed sale of Asset PR on the date of Husband's death

(\$100,000 minus \$25,000) and the amount Wife should be entitled to receive from Husband's executor.

(b) Community Property Situation.

Assume that (1) all of Husband's and Wife's assets, listed at the beginning of this example, are owned equally by them as their community property and are held in a joint revocable trust, (2) the trust instrument and/or state law authorizes the community property in the trust to be distributed by the trustee pro rata or otherwise between Husband and Wife following the death of the first one of them to die, and (3) Husband dies first. Following Husband's death, the trustee should administer the trust estate as follows:

Step 1

The trustee should first determine the potential income tax liability as if Assets PR, VH and MF were all sold on the date of Husband's death for their date-of-death values:

Total sales proceeds of all three Assets	\$2,500,000
Total Basis of all three Assets	-1,500,000
IRC Section 121 PR Exclusion	-500,000
General Exclusion	<u>-100,000</u>
Taxable Gain	\$400,000
Potential Income Tax Liability at 25%	\$100,000

This \$100,000 potential income tax liability amount should be allocated between Husband's and Wife's equal shares of the balance of the trust estate in proportion to the potential income tax liability attributable to the deemed realization of gain with respect to the way in which the assets are distributed to them.

Step 2

Assume that the trustee distributes the balance of the trust estate (excluding the \$100,000 referred to in Step 1) in equal shares as follows:

Wife's share

<u>Asset</u>	<u>Basis</u>	<u>FMV</u>
PR	400,000	1,200,000
Cash	250,000	250,000
Totals	\$ 650,000	\$ 1,450,000

Wife's Potential Income Tax Liability with respect to Asset PR is determined as follows:

Sales Proceeds of Asset PR	\$1,200,000
Basis of Asset PR	-400,000
IRC Section 121 Exclusion	-500,000
Taxable Gain	\$300,000
Income Tax Liability at 25%	\$75,000

Husband's share

<u>Asset</u>	<u>Basis</u>	<u>FMV</u>
VH	500,000	800,000
MF	600,000	500,000
Cash	150,000	150,000
Totals	\$ 1,250,000	\$ 1,450,000

Husband's Potential Income Tax Liability with respect to Assets VH and MF is determined as follows:

Combined Sales Proceeds of Assets VH and MF	\$1,300,000
Combined Basis of Assets VH and MF	-1,100,000
General Exclusion	-100,000
Taxable Gain	\$100,000
Income Tax Liability at 25%	\$25,000

Thus, the \$100,000 potential income tax liability amount referred to in Step 1, *supra*, should be allocated as follows: \$25,000 to Husband's share of the trust estate and \$75,000 to Wife's share of the trust estate.

Final distribution:

Husband's share of the Trust Estate:	$\$1,450,000 + \$25,000 =$	$\$1,475,000$
Wife's share of the Trust Estate:	$\$1,450,000 + \$75,000 =$	$\underline{-1,525,000}$
Total value of the Trust Estate:		$\$3,000,000$